AD-A200 217



DTIC
ELECTE
OCT 0 6 1988
S D
CSD

ADVANCED CONTRACT ADMINISTRATION

SECOND WEEK

FY 88.3

DISTRIBUTION STATEMENT A
Approved for public release
Distribution Unlimited

DEPARTMENT OF THE AIR FORCE
AIR UNIVERSITY
AIR FORCE INSTITUTE OF TECHNOLOGY
SCHOOL OF SYSTEMS & LOGISTICS
Wright-Patterson Air Force Base, Ohio

REVISED 14 APR 88
DAC 86-6
FAC 84-29

001
00106

UNCLASSIFIED
SECURITY CLASSIFICATION OF THIS PAGE

ADA200217

REPORT DOCUMENTATION PAGE

Form Approved
OMB No. 0704-0188

1a. REPORT SECURITY CLASSIFICATION UNCLASSIFIED	1b. RESTRICTIVE MARKINGS NONE
2a. SECURITY CLASSIFICATION AUTHORITY NA	3. DISTRIBUTION/AVAILABILITY OF REPORT Approved for public release/ distribution unlimited
2b. DECLASSIFICATION/DOWNGRADING SCHEDULE N/a	
4. PERFORMING ORGANIZATION REPORT NUMBER(S) AFIT/LSA/88-4	5. MONITORING ORGANIZATION REPORT NUMBER(S)
6a. NAME OF PERFORMING ORGANIZATION School of Systems and Logistics 6b. OFFICE SYMBOL (If applicable) AFIT/LSA	7a. NAME OF MONITORING ORGANIZATION
6c. ADDRESS (City, State, and ZIP Code) Air Force Institute of Technology Wright Patterson AFB OH 45433-6583	7b. ADDRESS (City, State, and ZIP Code)
8a. NAME OF FUNDING/SPONSORING ORGANIZATION 8b. OFFICE SYMBOL (If applicable)	9. PROCUREMENT INSTRUMENT IDENTIFICATION NUMBER
8c. ADDRESS (City, State, and ZIP Code)	10. SOURCE OF FUNDING NUMBERS PROGRAM ELEMENT NO. / PROJECT NO. / TASK NO. / WORK UNIT ACCESSION NO.
11. TITLE (Include Security Classification) Advanced Contract Administration (Unlcassified) Vol. 2 of 2 two volumes	
12. PERSONAL AUTHOR(S) HARPER, JAMES JR., MAJOR, USAF, et al	
13a. TYPE OF REPORT FINAL 13b. TIME COVERED FROM _____ TO _____	14. DATE OF REPORT (Year, Month, Day) 88 APR 14 15. PAGE COUNT 725
16. SUPPLEMENTARY NOTATION PPM 304	

17. COSATI CODES		
FIELD	GROUP	SUB-GROUP
05	01	

18. SUBJECT TERMS (Continue on reverse if necessary and identify by block number)
Contracting/Administrative Contracting Officer Relations Financial Management, Production Management, Quality Assurance, Subcontracting, Claims, Government Property, Ethics Data Sources and Modifications. (SDW)

19. ABSTRACT (Continue on reverse if necessary and identify by block number)
The purpose of these textbook is to assist the contracting professional in developing/improving those sources necessary to be proficient in contract administration. Keywords:

COORDINATION

SYMBOL	NAME	DATE
LSP	[illegible]	9/20/88
LSA	[illegible]	23 Sep 88
LS	[illegible]	9/29/88

20 DISTRIBUTION/AVAILABILITY OF ABSTRACT ☒ UNCLASSIFIED/UNLIMITED ☐ SAME AS RPT. ☐ DTIC USERS	21. ABSTRACT SECURITY CLASSIFICATION UNCLASSIFIED
22a. NAME OF RESPONSIBLE INDIVIDUAL MR. JON W. GRAHAM	22b. TELEPHONE (Include Area Code) (513) 255-6335 22c. OFFICE SYMBOL AFIT/LSA

DD Form 1473, JUN 86 *Previous editions are obsolete.* SECURITY CLASSIFICATION OF THIS PAGE

UNCLASSIFIED

CHAPTER F

Government Property

The use of government property can be advantageous to a contractor. It can eliminate the contractor's need to invest in equipment that may have little future business need.

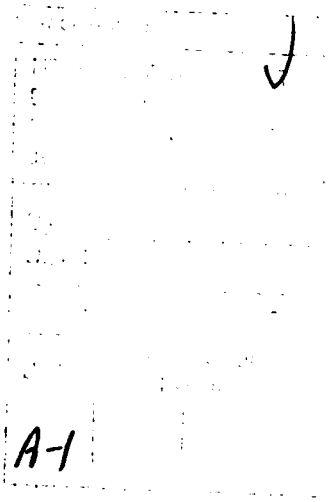
It may offer the contractor access to equipment unavailable in the commercial marketplace. The program of providing equipment to the contractors may prove beneficial to the government. By providing such assistance the price of the product should be reduced, less contractor risk, investment, etc. The specialized testing that may be necessary can be accomplished by use of that special test equipment only the government may possess.

At the same time, however, it may be determined that the use of government property actually becomes a disadvantage to a contractor. Perhaps the property that was provided did not work properly, or some pieces were missing. Perhaps the equipment was so large, the contractor's building required modification.

From the government's position, the fact that the government property proved defective could result in schedule slippages, additional cost as well as failed performance milestones.

How effectively we administer the government property available for use may dictate how (un)successful the program may become.

	TOPIC	PAGE	ASSIGNMENT
1.	Government Property	F-2 thru F-15	Read
2.	FAR Subsection 52.245-2	F-16 thru F-21	Review
3.	FAR Subsection 52.245-5	F-22 thru F-25	Review
4.	FAR Subsection 52.245-9	F-30 thru F-32	Review
5.	FAR Subsection 52.245-17	F-38 thru F-39	Review
6.	FAR Subsection 52.245-18	F-40	Review
7.	FAR Subsection 52.245-19	F-40 thru F-41	Review
8.	DFARS 45.301 - 45.306	F-42 thru F-46	Review
9.	DFARS 45.403	F-48	Read
10.	DFARS 45.407	F-49 thru F-50	Read
11.	DFARS 45.505-14	F-51 thru F-52	Read
12.	DFARS 45.7001	F-71 thru F-72	Read
13.	FAR Subsection 45.302	F-73 thru F-74	Read
14.	Questions	F-75 thru F-77	Review



SCHOOL OF SYSTEMS AND LOGISTICS

ADVANCED CONTRACT ADMINISTRATION COURSE (PPM 304)

SUBJECT: Government Property

TIME: 3.5 Hrs

OBJECTIVE: Comprehend the major responsibilities/decisions relating to government-owned property that must be addressed by the ACO.

SAMPLES OF BEHAVIOR:

a. Explain DOD policy on, and procedures for, furnishing property to contractors and requirements for retention and authorized use.

b. Describe policy and procedures for taking title to special tooling, special test equipment, and material.

c. Outline the responsibilities of the government in providing government-furnished property on time and suitable for the intended use.

d. Explain policy and procedures for rental computations and collections.

e. Defend the requirements for determining liability for loss, damage, or destruction of government-owned property.

f. Explain the policy and procedures for disapproval of a contractor's property control system.

g. Explain the property management interface between the contractor, contracting officer, property administrator and plant clearance officer.

h. Describe the procedures for government property disposal after contract completion.

INSTRUCTIONAL METHODS: Lecture/Discussion
Case Analysis

STUDENT INSTRUCTIONAL MATERIALS: ACA Textbook

REQUIRED STUDENT PREPARATION: As defined in Chapter "F" of the ACA textbook.

GOVERNMENT PROPERTY

The total value of government property provided to and managed by contractors is uncertain; however, knowledgeable government officials estimate the value to be in the tens of billions of dollars. This magnitude of investment and potential liability demands our attention. The ACO is clearly charged by the FAR to assure that property provided to contractors is used only as authorized in government contracts and that contractors are held accountable for non-compliance. The day to day activity to provide this assurance is performed by industrial property specialists who assist and advise the ACO. Our understanding of this topic is essential to effective Contract Administration.

This section defines the different categories of Government property, and states the policy and exceptions to the policy for providing Government owned property to contractors.

Categories. The FAR defines five broad categories of property, one of which contains two major subdivisions, as follows:

Types of Property	FAR
Facilities	45.301
a. Real property	45.101(a)
b. Plant equipment	45.101
Special tooling (ST)	45.101(a)
Special test equipment (STE)	45.101(a)
Material	45.301
Agency-Peculiar	45.301

Classification by type of property is very important for management purposes. There are different policies on furnishing property to contractors for different types of property. There are special clauses and special types of contracts for use with different types of property. Authorized use of government-owned property is related to type of property; and each type of property has different requirements for record keeping, reporting, and physical controls. Finally, there are different decisions, rules, and procedures related to title, retention, and disposition of these five FAR categories of property. Contractual documents, specifications, and plans should include these FAR terms to the maximum extent practicable in contractual provisions that relate to Government-owned property. Where use of a special term becomes mandatory, such as support equipment (SE), it should be further defined in terms of the standard definitions.

Facilities. Facilities means property, (other than material, special tooling, special test equipment and agency-peculiar property), for production, maintenance, research, development, or test, including real property and rights therein, buildings, structures, improvements and plant equipment. For financial reporting and management purposes, facilities are divided into two separate categories: real property and plant equipment.

a. Real Property. Real property means land and rights therein, ground improvements, utility distribution systems, buildings, and structures. Generally, real property meets the test of being nonseverable, which means

that such property cannot be removed after erection or installation without substantial loss of value or damage thereto, or to the premises where installed. However, this category excludes foundations and other work necessary for the installation of special tooling, special test equipment, or plant equipment.

b. Plant Equipment. Plant equipment is personal property of a capital nature, including equipment, machine tools, test equipment, furniture, vehicles, and accessory and auxiliary items, for use in manufacturing supplies, performing services, or for any administrative or general plant purpose. However, it does not include special tooling or special test equipment. The Department of Defense FAR Supplement categorizes plant equipment into two subcategories; industrial plant equipment (IPE) and other plant equipment (OPE).

(1) Industrial Plant Equipment (IPE). This type of facility is that part of plant equipment with an acquisition cost of ..,000 or more. IPE items are those items used for cutting, abrading, grinding, shaping, forming, joining, testing, measuring, heating, treating, or otherwise altering the physical, electrical or chemical properties of materials, components or end items entailed in manufacturing, maintenance, supply processing, assembly, or research and development operations. The ultimate definitive characteristic of IPE is that such items are identified by noun name in Joint DOD Handbooks published by the Defense Industrial Plant Equipment Center (DIPEC), as listed in FAR DOD Supplement section 45.301. Essentially, then, an item is a piece of IPE if DIPEC chooses to manage it as IPE. No new items of IPE can be purchased by any DOD component at any time, for any reason, without first checking with DIPEC and receiving a certificate of Non-Availability (CNA).

(2) Other Plant Equipment (OPE). The FAR DOD Supplement defines OPE as "that part of plant equipment, regardless of dollar value, which is used in or in conjunction with the manufacture of components, or end items relative to maintenance, supply, processing, assembly or research and development operations, but excluding items categorized as IPE. The major point is that if it isn't IPE, it is, of course, OPE.

Special Tooling (ST). This type of property is defined as all jigs, dies, fixtures, molds, patterns, taps, gauges, other equipment and manufacturing aids, and replacements thereof, which are of such a specialized nature that, without substantial modification or alteration, their use is limited to the development or production of particular supplies or parts thereof, or the performance of particular services. The term includes all components of such items, but does not include material (consumable property); special test equipment; or buildings, nonseverable structures (except foundations and similar improvements necessary for the installation of special tooling), general or special machine tools, or similar capital items.

The primary characteristic in identifying an item as special tooling is the word "special". There are many general-purpose items of tooling required in industrial operations, many of them being standard commercial, off-the-shelf types of items. These are properly identified, purchased, and accounted for as plant equipment. Only if its use is limited to the production of particular supplies or the performance of particular services can an item be properly identified as special tooling.

Special Test Equipment (STE). Special test equipment means either single or multipurpose integrated test units engineered, designed, fabricated, or modified to accomplish special purpose testing in performance of a contract. It consists of items or assemblies of equipment interconnected and interdependent so as to become a new functional entity for special testing purposes. The term "special test equipment" does not include material, special tooling, buildings and nonseverable structures (except foundations and similar improvements necessary for the installation of special test equipment), or plant equipment items used for general plant testing purposes.

The distinguishing characteristic of this type of property is the emphasis on items being interconnected, interdependent, and essential for performance of special purpose testing. Quite often, a piece of STE is a whole room or vehicle full of equipment. Certain items included in a piece of STE might, by themselves, be industrial plant equipment. However, while they are incorporated into a piece of STE they lose their identity.

Material. Material means property which may be incorporated into or attached to an end item to be delivered under a contract, or which may be consumed in the performance of a contract. It includes, but is not limited to, raw and processed material, parts, components, assemblies and small tools, and supplies. The primary features that identify an item as material are incorporation into a deliverable end item and/or consumption in the industrial processes.

Agency-Peculiar Property. Agency-peculiar property means government-owned personal property that is peculiar to the mission of one agency. It excludes government material, special test equipment, special tooling, and facilities. Each department or agency furnishes property unique to that organization, and, as such, unique processing and controls are established. For example, the DOD has "military property" and NASA has "space hardware".

Military Property. Military property means personal property designed for military operations. It includes end-items and integral components of military weapons systems, along with the related peculiar support equipment which is not readily available as a commercial item. It does not include government material, special tooling, special test equipment, or facilities. There appear to be significant differences of opinion as to what is required to properly identify and account for an item as a piece of military property. One guideline that would appear to be helpful is the concept of control by a military inventory control point. It seems obvious that, if an asset is retained on the accountable records of the inventory manager during the time it is in the hands of a contractor and if disposition of the item can be made only by direction of the inventory manager, the item should be treated as military property.

Space Hardware. "Space hardware" applies only to those items identified in the Annual List of Selected Items of Space Hardware. It includes personal property which is unique to aeronautical and space programs of NASA and not identified in one of the other categories.

The basic guidance for providing government owned property to contractors is given to contracting officers in FAR Part 45. Such a complex set of instructions is not easily summarized, but there does seem to be a pattern which should be used by procuring agencies with respect to the furnishing of

property to contractors. The initial premise is that the contractor is expected to furnish all assets required for performance of the contract. If the contractor is unwilling or unable to provide all the resources needed, the government should first make every possible effort to furnish, or offer, existing assets that are suitable for the work to be accomplished. If existing assets are not available, are not suitable, or cannot be provided in a timely manner, the Government can authorize the purchase or fabrication of whatever property will be required.

Facilities. The basic policy, as found in FAR 45.302-1, directs that the contractors shall furnish all the facilities required including restoration, replacement, or modernization - with certain exceptions:

a. Those used in a government-owned, contractor-operated plant (GOCO) on a cost basis.

b. Those for support of industrial preparedness programs.

c. The components of ST or STE acquired or made at Government expense.

d. By a finding of the Agency Head that it would be in the public's best interest.

e. As otherwise authorized by law.

The FAR further provides that agencies will not supply new facilities unless existing government-owned facilities are either inadequate or cannot economically be furnished. Also, R & D funds are not to be used to provide new construction or improvements of general utility, and, unless authorized by law, agencies cannot provide facilities that will be solely for non-government use. Policy also dictates that new or existing facilities will not be offered to potential contractors unless adequate price competition cannot be obtained otherwise. For facilities having a unit cost of less than $10,000, the government will provide these only to a nonprofit higher education institution or a scientific research organization; to a contractor operating a GOCO; to a contractor with a contract permitting acquisition of ST or STE with the contracting officer's approval; or if the facilities are not available, from other government sources.

Special Tooling. If the government has ST currently in existence, it may be offered to the contractor if it does not disrupt programs of equal or higher priority, it is available, and is advantageous to the government to do so. But when the ST does not exist, the contractor should ordinarily provide it and retain title to it. In those competitive situations where the contractor amortizes the costs of the ST, the government will not usually take title. However, where competition is inadequate, it is appropriate for the government to take title. In deciding whether to exercise this right, the contracting officer should consider the current or probable future need for this item, its estimated residual value, the administrative burden, the cost of making the items available in the future, any amount offered by the contractor to retain the ST, and the effect on future competition and contract pricing. Basically, this is a cost-benefit analysis by the contracting officer.

Special Test Equipment. For all practical purposes, the policy on furnishing special test equipment is the same as for special tooling. The basic considerations are found in FAR 45.307-1. With this category of property, there is an ever-present danger of providing general-purpose, commercially available equipment to the contractor. In many cases, some of the individual components required to fabricate a piece of special test equipment will be general-purpose items. There is also a special requirement for screening of existing government-owned assets for all such items over $1,000, in accordance with agency procedures.

Material. As set forth in FAR 45.303-1 the policy on material is very clear - the contractor is expected to furnish it all. However, in one large category of contracts, namely, maintenance and overhaul contracts, it is very common to supply all necessary parts from military supply system stocks. Similarly, there are many contracts performed outside the Continental United States; contracts performed in remote areas; and contracts performed on military bases -- in all of these cases, it may be quite routine for the contractor to obtain supplies and parts through the military supply system.

Agency-Peculiar Property. This type of property is provided whenever the contracting officer determines that it is necessary and in the Government's best interest. Such instances may occur where the item is to be used as a standard or model, to establish equipment compatibility such as fitting a tarpaulin to a truck bed, or where there are no commercial suitable substitutes. The items may be as large as a complete airplane.

Providing Government Property. Government-owned property in the hands of contractors should be considered as an aid to procurement. There are many reasons why property owned by the Government may be acquired by or provided to contractors. Several of the factors and reasons are briefly explained below.

Type of Contract. On a cost-reimbursement type of contract, all assets acquired or produced that are paid for by the Government are, by definition, government-owned property.

Economy. A major reason for furnishing property to contractors is to obtain a more favorable price. The cost may be reduced if the contractor does not have to acquire or build certain types of assets that the government already owns.

Standardization. When several contractors are working on a similar project or production item, it may be desirable for the Government to furnish the equipment or materials in order to assure uniformity in the end product.

Security. Sometimes, performance of the contract requires the use of classified items (top secret, secret, confidential) which can only be provided to the contractor by the Government.

Increased Competition. In those situations where only a limited number of contractors are interested in responding to a government solicitation because of expensive tooling or exotic machinery required, government-furnished property (GFP) may increase the number of potential bidders by removing some of the main handicaps to their participation. In some cases, GFP may contribute to breaking out of a sole-source situation.

Support of Small Business. A small business may have the labor, skills, and sources of material that are required to perform certain types of government contracts, but may not be able to afford the investment in certain expensive or unique items of equipment. Government-furnished equipment can be used in such instances to support the DOD policy of aid to small business.

To Expedite Production. Many tools, equipment, and materials need long lead-times to produce or acquire. If the Government can make such items available from existing stocks, the lead time for end-item production may be reduced by substantial margins.

Scarcity of Assets. Some types of items required for performance of government contracts are of such a critical nature and in such limited supply that only the government can guarantee availability of the required quantity at the required time.

To Maintain the Industrial Base. Experience in several major wars has taught us that certain types and quantities of industrial equipment and tooling must be available at all times in order to provide a base for rapid production of essential military end items. Private industry is neither willing nor able to maintain the investment in equipment required for this purpose. As a result, government-owned assets are used to supplement the industrial capability of the civilian economy.

Objectives: The objectives of government property management parallel those of the property administration function. Each, strive to assure that the management effort supports contract performance, it implements official policy, and it is performed in an economical manner.

Support Contract Performance. The objective of DOD procurement is to procure supplies and services that meet the needs of the ultimate user at fair and reasonable prices calculated to result in the lowest overall cost to the government. Industrial property required to produce or support the procurement must be obtained or provided in a timely and economical manner.

Implement Policy and Goals. Since the mid-1960's, numerous policy statements and programs issued by top DOD officials have stressed the importance of continued attention to:

a. Prevent or avoid excessive quantities.

b. Establish proper inventory levels.

c. Achieve full utilization.

d. Encourage appropriate redistribution in lieu of new procurement.

e. Promptly identify and dispose of excesses and surpluses.

Implicit in these objectives is a requirement to follow the provisions of the contract, the FAR, and appropriate Service manuals and instructions. Implicit, also, is a requirement to exercise judgment to establish "sound industrial practice."

Reduce Costs of Management. A final overall objective is to reduce the costs of both government and contractor management efforts. Although we cannot afford to pay for perfect accountability and control over these as assets, there is some minimum level of control which must be obtained.

The emphasis of the government's property management program is to make the contractor responsible for maintaining an acceptable system. Some functions and transactions are totally controlled by the contractor. In some areas, the contractor's system must interact properly with the various portions of the government system, the contract administration office, the buying office, the inventory manager, and so forth. The government performs a surveillance effort over the contractor's system. Its basic concerns are:

a. What types and amounts of property does the contractor have? Is it properly classified?

b. Should we have it, that is, is it required for contract performance and was it acquired properly?

c. Is it used only as authorized?

d. Is proper care being taken in the government's ownership interest?

e. Is it properly accounted for?

The system for managing government-owned property is derived from two basic requirements: know what you need and know what you have. Knowing what you need requires a system for the initial requirement determination and procurement; it also calls for a periodic review of requirements to consider continued retention or disposition. Knowing what you have calls for a system of accountability and control over the property. This system must insure proper use, maintenance, protection, and disposition.

Figure G-1 summarizes the property management processes, and depicts the life cycle of an item of property or the flow of property through a contractor's property control system. This flow chart is useful for making some observations and generalizations about the division of responsibilities for property management.

Requirements Determination. Property management begins and ends with requirements determination. There are many different individuals and organizations who may have responsibilities for this function. The initial requirement is normally established outside the organization of the ACO, and is often outside the contractor's organization. After the contractor has custody of the property, the contractor, the ACO, and the property administrator have important responsibilities for a review of the requirement for continued retention.

Acquisition. There are many different methods by which a contractor comes into possession of government-owned property, and there are several ways to categorize these methods of acquisition. One important distinction is whether the source is internal or external to the contractor's operation. Internal sources include fabrication and issue from contractor-owned stores. With regard to external sources, there are two basic methods of acquiring property: by purchase or by requisition from government sources, normally through the use of MILSTRIP (military standard requisitioning and issue procedures).

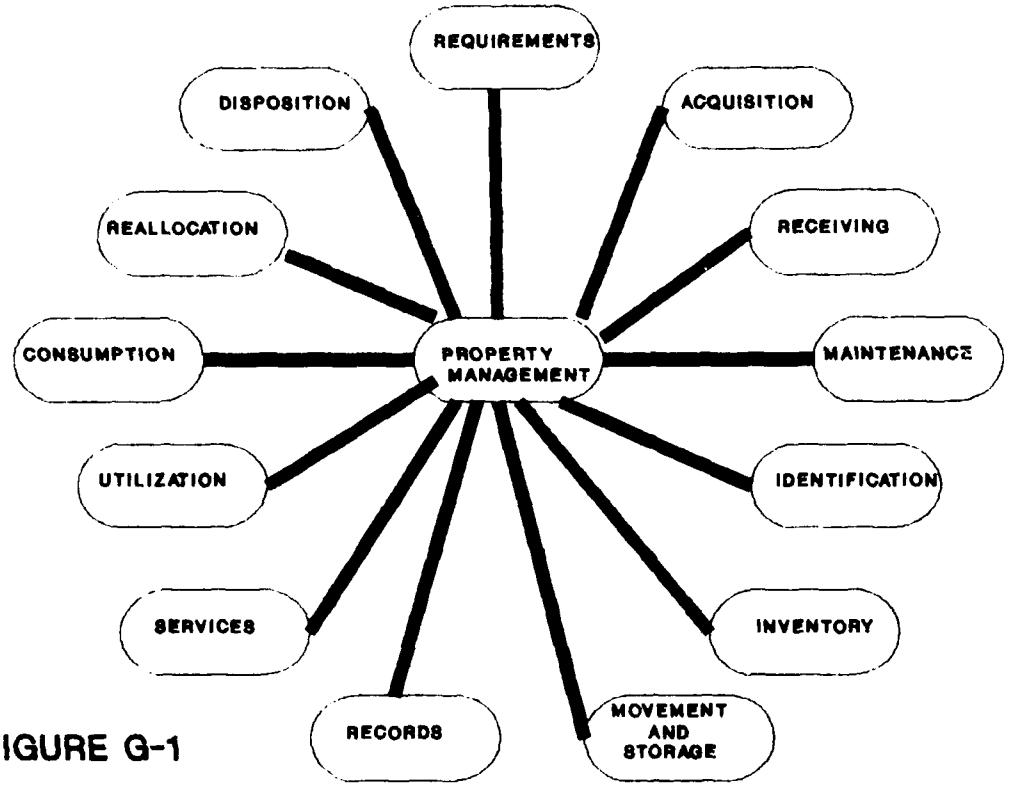

REQUIREMENTS
ACQUISITION
RECEIVING
MAINTENANCE
IDENTIFICATION
INVENTORY
MOVEMENT AND STORAGE
RECORDS
SERVICES
UTILIZATION
CONSUMPTION
REALLOCATION
DISPOSITION
PROPERTY MANAGEMENT

FIGURE G-1

use of MILSTRIP (military standard requisitioning and issue procedures). Another way to look at external sources is from the standpoint of who initiates the action. Property can be "pushed" by an outside agency of the government or by another contractor, or it can be "pulled" into the contractor's property control system through the use of contracts and purchase orders or through the use of MILSTRIP requisitions. When all of these things are taken into consideration, the acquisition function can be very complex.

Custody. A major distinguishing feature of our government property management program is the fact that, for the most part, ownership is divorced from managership. Generally speaking, from the time the property comes into the custody of the contractor, it is expected to exercise a complete range of management functions. These custody functions include provisions for the physical control and handling of the property, reasonable accountability, and appropriate review of the requirement for retention and continued use. The contractor is the manager of the property. It must have an acceptable system for performing all of the management functions with respect to this property.

Disposition. The disposition function is not totally divorced from the contractor's property control system; but it is off to one side, and does not come into play until the decision-making process has dealt with the retention issue. Contractors may be relieved from management responsibilities but this does not mean they are relieved from liability.

Surveillance. There is no separate block in figure 12-1 to illustrate the surveillance efforts of the property administrator. The property system survey by the Property Administrator PA and investigations of loss, damage, destruction, or unreasonable consumption are integral parts of the property management processes. In addition, the PA takes an overall look at the contractor's system to insure that it is tied together properly and to evaluate whether it is working.

The best interest of the government must be considered when providing government property. The responsibilities of the government, property administrator, and contractor are clearly interdependent to each other for satisfactory property administration.

Contractor Responsibilities. For the most part, the contractor is the manager of the government-owned property. Those responsibilities are enumerated in, or can be derived from, the provisions of the government property clause. In general, the contractor must:

- Use the property only for authorized purposes.
- Account for such use.
- Maintain and control it properly.
- Dispose of it as directed.
- Protect the Government's ownership interests.

Most of these management responsibilities involve development and implementation of a property control system which is reviewed and approved by the property administrator. The clause clearly points out that some of these responsibilities involve action and decisions on the part of the contracting officer. The use of the property is to be as spelled out in the contract or as otherwise approved by the contracting officer. Likewise, the final accounting or disposition of the property shall be as directed or authorized by the contracting officer.

sonal property by being attached to any real proper-

(v) That results from a failure on the part of the

Government Responsibilities. The first paragraph of the government property clause covers the responsibility of the government with respect to furnishing property. It gives the contractor a very strong weapon in case the government fails in its responsibility. The conditions agreed to by the government in this paragraph are to get the property to the contractor on time and in a condition suitable for its intended use. In effect, this is a government warranty for timeliness and suitability.

The common remedy in the commercial world, when one party fails to live up to an agreement, is a suit for breach of contract. The property clause precludes the use of such a suit against the government. The remedy given to the contractor when the government fails to live up to these warranties is entitlement to an equitable adjustment.

Timely Delivery of Government Furnished Property. The delivery or performance dates agreed to by the contractor are contingent upon receipt of the property "at the times stated in the Schedule or, if not so stated, in sufficient time to enable the contractor to meet the contract's delivery or performance dates." The contractor is expected to notify the contracting officer, in writing, in the event GFP is not received on time. The contracting officer will then make a determination of the delay and will equitably adjust the delivery or performance dates or the contract price, or both, and any other contractual provision affected.

Warranty of Suitability. In the event the condition of the GFP is not suitable for its intended use the contractor is expected to notify the contracting officer in writing of the deficiency and await instructions. For example, drawings may have been furnished which are defective; equipment or special tooling may have been furnished which are unusable or which produce extraordinary scrap or reject rates; or the equipment furnished may require considerable time and expense to put it in a serviceable condition.

The contracting officer may direct that the property be returned at government expense or otherwise disposed of, or he may authorize appropriate repairs or modifications. In addition, when requested by the contractor, the contracting officer will equitably adjust the delivery or performance dates or the contract price, or both.

"As Is" Property. Paragraph (a)2 of the government property clause makes one exception to the warranty of suitability - property furnished on an "As Is" basis. The "As Is" government property clause provides that "the government makes no warranty whatsoever with respect to government property furnished "as
is" . Essentially the same provisions are found in the representations and warranties clause used in facilities contracts.

The intent of these clauses is to put the contractor on notice that the property offered by the government for use in performance of the contract may be inspected and rejected. If the contractor chooses to use the property, he does so at his own peril and his own expense.

The responsibilities of the government for furnishing property on an "As Is" basis are enumerated in FAR 45.308. The substance of these requirements include the following:

a. The contract should be written in such a manner as to clearly identify the property being offered or furnished on an "As Is" basis. Both the government property clause and the "As Is" clause should be incorporated as part of the general provisions; and in the schedule of the contract, there should be a complete identification of the GFP that is related to the "As Is" provision.

b. Disclose the location and condition of the property. The contractor(s) should be given a thorough understanding of where the property is and what condition it is in so they can evaluate the situation in preparing their bid or proposal.

c. Allow the contractor to inspect the property. Each contractor should be afforded every opportunity to inspect the property and analyze the suitability for its intended use. The contractor(s) may find it unsuitable or that certain costs will be incurred to transport, install, modify or repair the items. These costs must be taken into consideration in preparing a bid or proposal.

d. If property is offered to one or more bidders and not to others, or if some bids are made on the basis that the property will be used while others choose not to do so, the contracting officer must ensure that appropriate offsets are made to eliminate any competitive advantage.

Functions of the Property Administrator. One of the key individuals on the government property management team is the property administrator. His/her role and methods of operation vary with the agency, type of contractor, and so forth. A property administrator is responsible for:

a. Assisting and directing negotiations with contractors in the establishment of adequate industrial property control systems.

b. Evaluating and approving or recommending for disapproval contractor's policy, procedures, techniques, and changes thereto, pertaining to the management of government property. The ACO retains the authority to dissapprove the contractor's system.

c. Developing, planning, scheduling, or performing system surveys to analyze, test, and evaluate the contractor's system for Government property management.

d. Maintaining surveillance over the contractor's property management system to assure that the contractor meets the requirements and obligations of each assigned contract.

e. Disclosing and evaluating conditions of loss, damage, or destruction of Government property and determining contractor's liability.

f. Evaluating inventory adjustments and approving those determined to be reasonable.

g. Taking other actions with regard to government property necessary to protect the government's interest.

h. Resolving property administration questions as necessary with the contractor's management personnel, government procurement, logistic and audit agencies, and other concerned government departments and agencies.

Resident Property Administrator. In all three services and in DLA, there are property administrators whose full-time efforts are in one plant or location, dealing continuously with a large contractor and a complex property control system involving large amounts of property. All contract administration offices where the services have retained plant cognizance fall into this category. These include the AFPROs, NAVPROs, and Army Plant Activities. Other examples include GOCO plants, most of the Navy Supervisor of Shipbuilding (SUPSHIPS) offices, and most of the detachments of the Contract Maintenance Center of Air Force Logistics Command.

Itinerant Property Administrator. In DLA, most property administrators have an area-wide responsibility, performing surveillance over a large number of contractors with lower dollar value contracts and smaller amounts of government-owned property. With so many contractors and so many different types of contracts, the itinerant property administrator does not have a close, continuing relationship with the contractor, and cannot develop an intimate knowledge of each property management system. As a result, the surveillance techniques of the itinerant are significantly different from those of the resident property administrator, with a heavy reliance on the "management by exception" principles and frequent assistance from the industrial specialist, the quality assurance representative, and others on the Contract Administration team.

Liability. One of the more confusing issues in the property management business is the extent to which the contractor should be held liable for loss, damage, or destruction of government-owned property. One thing is very clear in this regard, however; it is the interface between the property administrator and the contracting officer. The property administrator has authority to relieve the contractor of liability, but only the administrative contracting officer has authority to hold the contractor liable.

Another general item which is perhaps not quite so clear, is the distinction between loss and consumption of property. There is no precise definition of "consumption" in the FAR; but the common understanding is that consumption takes place when material is issued to use, that is, when it becomes work-in-process. Let us assume, for instance, that the contractor had material in storage and now it is gone. The fact that the material is gone, missing, and unaccounted for raises the question of liability. However, let us assume that the contractor issued material to the production line and now it is gone. FAR 45.503 says that consumption for proper purposes and in reasonable amounts in the performance of the contract relieves the contractor from responsibility for the property. Therefore, the fact that such material is gone does not raise the issue of liability; there must be evidence to show that material has been consumed in unreasonable amounts. The latter determination is not one of liability for loss, but one of reasonableness of cost incurrence. In either case, the decision is up to the contracting officer.

Reporting and Investigation of Losses. The contractor is required to report all instances of loss, damage, or destruction of government property in his/her possession or control to the property administrator (PA) as soon as

such facts become known or when requested by the property administrator. The PA is expected to investigate the incident to reach a valid and supportable conclusion as to the liability of the contractor, and to take any adjustment action required. If the PA concludes that the incident constituted a risk assumed by the government, the contractor should be advised in writing, thereby relieving the contractor of responsibility. If the contractor acknowledges liability, the property administrator will forward a copy of the credit memorandum or other adjustment document to the ACO and the auditor, if appropriate, to assure proper credit. If the PA determines that the contractor should be held liable for loss, damage, destruction, or unreasonable consumption, he/she will forward the complete file on the incident, with conclusions and recommendations, to the ACO for review and determination.

Read FAR Part 45.504 before continuing.

Policy on Assumption of Risk. The basic policy of the Department of Defense is to not hold a contractor responsible for loss of or damage to government property when such property is provided under a facilities contract, a noncompetitive negotiated, fixed price contract, or a cost-type contract.

Essentially, the risk of loss for Government-owned property depends upon the pricing arrangements. As described below, the contractor may assume all of the risk, or alternatively, practically none.

Competitive Fixed Price. On one side of the spectrum is the regular provision of the property clause for competitively awarded fixed price contracts. This holds the contractor liable for any loss or damage to the property except reasonable consumption, or wear and tear. It does not make any difference if there is negligence involved. The contractor is to treat the property as though it were his own and to insure the property for any potential risks. This is a good point to bring up at a preaward or post award conference. Many contractors think it is the policy for the government to always be a self-insurer. They may not realize what they are getting into when they are furnished government property on a competitive firm fixed price contract.

Cost Reimbursement. At the other extreme are the cost reimbursement contracts for which the government acts as a self-insurer for almost all risks. Even on these contracts the government may decide, to specify, in a schedule provision, certain types of risk to be insured by the contractor. Generally, there is only one thing for which the contractor can be held liable on cost-type contracts, is willful misconduct or lack of good faith of managerial personnel. This would also not be covered in a commercial insurance policy. Willful misconduct of top managers is far from simple negligence on the part of employees or even, of middle management personnel.

Unless there are criminal acts, such as arson, theft, misappropriation, and so forth, which can clearly be attributed to top management, it is probably impossible to prove that an act of management is of such gross negligence as to constitute willful misconduct.

The authorities are unanimous in holding that proof of negligence does not establish willful misconduct or lack of good faith. Mere indifference to duty also is not enough. Willful misconduct has been described as the conscious failure to use the necessary means to avoid peril and indifference to its consequences.

Noncompetitive Negotiated Fixed Price. In between the straight fixed-price and the cost-type contract is Alternate I to the basic fixed price clause which is to be used in negotiated fixed-price contracts for which the price is not based on adequate price competition, established catalog or market prices, or prices set by law or regulation. This provision is basically the same as the cost reimbursement provision.

The risk of loss provisions of the cost-type and noncompetitive fixed-price type contracts state that the contractor is responsible for any failure resulting from willful misconduct of the contractor's managerial personnel.

If it can be established that losses of government-owned property are attributable to such management failure, the contractor should be held liable for such losses. This seems to be the only effective way for the government to establish willful misconduct or lack of good faith.

The basic risk of loss provisions establishing the contractor's liability for government-Owned Property is summarized:

FAR PROPERTY CLAUSE	CONTRACTOR IS LIABLE FOR:
1. 52.245-2 Used in competitive Fixed Price	Any loss or damage, except: reasonable consumption reasonable wear and tear
2. 52.245-2 Alternate I Used in noncompetitive negotiated Fixed Price Contracts	1. Specific schedule provision 2. Willful misconduct of top managers 3. Lack of good faith 4. Insured losses
3. 52.245-5 Used in Cost Reimbursement Contracts	1. Willful misconduct of top managements 2. Specific schedule provision 3. Lack of good faith 4. Insured losses

Effect of Approval/Disapproval of the Contractor's Property System. The property administrator (PA) is charged with the responsibility of reviewing and approving or recommending to the contracting officer disapproval of the contractor's property control system. The PA must first notify the contractor in writing of its system deficiencies, seeking their correction. Should the contractor fail to comply within a "reasonable period", the PA will advise the contracting officer of this failure, and if the contracting officer concurs, the contracting officer will"notify the contractor in writing of any required corrections and establish a schedule for completion of actions". If the required actions are not accomplished in a timely fashion, the contracting officer should formally advise the contractor that approval of the property

control system is withheld or withdrawn. This notice should advise the contractor that liability for loss or damage to government property may be borne by the contractor.

The exact meaning of disapproval (or partial disapproval) is subject to some interpretation. Referring to the words of the risk of loss provision, the clause states first that failure to maintain an acceptable property control system is conclusive proof that the contractor is guilty of willful misconduct. It goes on to say that there is a conclusive presumption that any loss or damage to government property may be considered a result of such failure. This would appear to give the government an airtight case.

However, the clause states the contractor can escape liability if he can establish by clear and convincing evidence that the loss did not result from his failure to maintain an acceptable system. It is difficult for the property administrator to clearly establish a causal relationship between the reason for the loss and the reason why the contractor's property control system was disapproved. The formal notice given to the contractor by the contracting officer should be very precise as to the deficiencies in the system, the corrective action required, and the change in the nature of the contractor's liability.

Redistribution. "Screening" is that process by which usable or serviceable property that is not purchased or retained by the contractor is examined for use by other governmental agencies before being offered for sale or donation. Standard screening applies to property with a value in excess of $500 and which does not fit into another category. Agency screening is a screening for use within the contracting agency. Limited screening is used for those items that are scrap or have limited potential for use. Special item screening is applied to items such as Special Test Equipment STE, printing equipment, or Automated Data Processing Equipment ADPE.

Numerous programs establish reserves of industrial equipment or central records of such equipment in order to satisfy defense production requirements. The purpose of these programs is to achieve maximum redistribution and reutilization of these assets to preclude spending new procurement dollars for duplicate items.

Plant Equipment Packages. Many buying agencies, as part of their industrial preparedness planning, have established plant equipment packages (PEP's). A plant equipment package may consist of a single piece of equipment with associated tools and accessories, a group of related equipments, a complete production line, or even an entire plant. These assets may be in an active, standby, or layaway status; they may be located in a contractor plant, a GOCO plant, or in Government or commercial storage. Each agency has instructions that regulate the conditions under which these assets may be offered to contractors.

DIPEC Screening. The Defense Industrial Plant Equipment Center at Memphis, Tennessee, is charged with the management of the DOD Industrial Equipment Reserve (DODIER), consisting of both the General Reserve and component Mobilization Reserves. Assets in the General Reserve are available for screening and redistribution.

52.245-2 Government Property (Fixed-Price Contracts).

As prescribed in 45.106(b)(1), insert the following clause:

GOVERNMENT PROPERTY (FIXED-PRICE CONTRACTS) (APR 1984)

(a) *Government-furnished property.* (1) The Government shall deliver to the Contractor, for use in connection with and under the terms of this contract, the Government-furnished property described in the Schedule or specifications together with any related data and information that the Contractor may request and is reasonably required for the intended use of the property (hereinafter referred to as "Government-furnished property").

(2) The delivery or performance dates for this contract are based upon the expectation that Government-furnished property suitable for use (except for property furnished "as-is") will be delivered to the Contractor at the times stated in the Schedule or, if not so stated, in sufficient time to enable the Contractor to meet the contract's delivery or performance dates.

(3) If Government-furnished property is received by the Contractor in a condition not suitable for the intended use, the Contractor shall, upon receipt of it, notify the Contracting Officer, detailing the facts, and, as directed by the Contracting Officer and at Government expense, either repair, modify, return, or otherwise dispose of the property. After completing the directed action and upon written request of the Contractor, the Contracting Officer shall make an equitable adjustment as provided in paragraph (h) of this clause.

(4) If Government-furnished property is not delivered to the Contractor by the required time, the Contracting Officer shall, upon the Contractor's timely written request, make a determination of the delay, if any, caused the Contractor and shall make an equitable adjustment in accordance with paragraph (h) of this clause.

(b) *Changes in Government-furnished property.* (1) The Contracting Officer may, by written notice, (i) decrease the Government-furnished property provided or to be provided under this contract, or (ii) substitute other Government-furnished property for the property to be provided by the Government, or to be acquired by the Contractor for the Government, under this contract. The Contractor shall promptly take such action as the Contracting Officer may direct regarding the removal, shipment, or disposal of the property covered by such notice.

(2) Upon the Contractor's written request, the Contracting Officer shall make an equitable adjustment to the contract in accordance with paragraph (h) of this clause, if the Government has agreed in the Schedule to make the property available for performing this contract and there is any—

(i) Decrease or substitution in this property pursuant to subparagraph (b)(1) above; or

(ii) Withdrawal of authority to use this property, if provided under any other contract or lease.

(c) *Title in Government property.* (1) The Government shall retain title to all Government-furnished property.

(2) All Government-furnished property and all property acquired by the Contractor, title to which vests in the Government under this paragraph (collectively referred to as "Government property"), are subject to the provisions of this clause. Title to Government property shall not be affected by its incorporation into or attachment to any property not owned by the Government, nor shall Government property become a fixture or lose its identity as personal property by being attached to any real property.

(3) Title to each item of facilities, special test equipment, and special tooling (other than that subject to a special tooling clause) acquired by the Contractor for the Government under this contract shall pass to and vest in the Government when its use in performing this contract commences or when the Government has paid for it, whichever is earlier, whether or not title previously vested in the Government.

(4) If this contract contains a provision directing the Contractor to purchase material for which the Government will reimburse the Contractor as a direct item of cost under this contract—

(i) Title to material purchased from a vendor shall pass to and vest in the Government upon the vendor's delivery of such material; and

(ii) Title to all other material shall pass to and vest in the Government upon—

(A) Issuance of the material for use in contract performance;

(B) Commencement of processing of the material or its use in contract performance; or

(C) Reimbursement of the cost of the material by the Government, whichever occurs first.

(d) *Use of Government property.* The Government property shall be used only for performing this contract, unless otherwise provided in this contract or approved by the Contracting Officer.

(e) *Property administration.* (1) The Contractor shall be responsible and accountable for all Government property provided under this contract and shall comply with Federal Acquisition Regulation (FAR) Subpart 45.5, as in effect on the date of this contract.

(2) The Contractor shall establish and maintain a program for the use, maintenance, repair, protection, and preservation of Government property in accordance with sound industrial practice and the applicable provisions of Subpart 45.5 of the FAR.

(3) If damage occurs to Government property, the risk of which has been assumed by the Government under this contract, the Government shall replace the items or the Contractor shall make such repairs as the Government directs. However, if the Contractor cannot effect such repairs within the time required, the Contractor shall dispose of the property as directed by the Contracting Officer. When any property for which the Government is responsible is replaced or repaired, the Contracting Officer shall make an equitable adjustment in accordance with paragraph (h) of this clause.

(4) The Contractor represents that the contract price does not include any amount for repairs or replacement for which the Government is responsible. Repair or replacement of property for which the Contractor is responsible shall be accomplished by the Contractor at its own expense.

(f) *Access.* The Government and all its designees shall have access at all reasonable times to the premises in which any Government property is located for the purpose of inspecting the Government property.

(g) *Risk of loss.* Unless otherwise provided in this contract, the Contractor assumes the risk of, and shall be responsible for, any loss or destruction of, or damage to, Government property upon its delivery to the Contractor or upon passage of title to the Government under paragraph (c) of this clause. However, the Contractor is not responsible for reasonable wear and tear to Government property or for Government property properly consumed in performing this contract.

(h) *Equitable adjustment.* When this clause specifies an equitable adjustment, it shall be made to any affected contract provision in accordance with the procedures of the Changes clause. When appropriate, the Contracting Officer may initiate an equitable adjustment in favor of the Government. The right to an equitable adjustment shall be the Contractor's exclusive remedy. The Government shall not be liable to suit for breach of contract for—

(1) Any delay in delivery of Government-furnished property;

(2) Delivery of Government-furnished property in a condition not suitable for its intended use;

(3) A decrease in or substitution of Government-furnished property; or

(4) Failure to repair or replace Government property for which the Government is responsible.

(i) *Final accounting and disposition of Government property.* Upon completing this contract, or at such earlier dates as may be fixed by the Contracting Officer, the Contractor shall submit, in a form acceptable to the Contracting Officer, inventory schedules covering all items of Government property (including any resulting scrap) not consumed in performing this contract or delivered to the Government. The Contractor shall prepare for shipment, deliver f.o.b. origin, or dispose of the Government property as may be directed or authorized by the Contracting Officer. The net proceeds of any such disposal shall be credited to the contract price or shall be paid to the Government as the Contracting Officer directs.

(j) *Abandonment and restoration of Contractor's premises.* Unless otherwise provided herein, the Government—

(1) May abandon any Government property in place, at which time all obligations of the Government regarding such abandoned property shall cease; and

(2) Has no obligation to restore or rehabilitate the Contractor's premises under any circumstances (e.g., abandonment, disposition upon completion of need, or upon contract completion). However, if the Government-furnished property (listed in the Schedule or specifications) is withdrawn or is unsuitable for the intended use, or if other Government property is substituted, then the equitable adjustment under paragraph (h) of this clause may properly include restoration or rehabilitation costs.

(k) *Communications.* All communications under this clause shall be in writing.

(l) *Overseas contracts.* If this contract is to be performed outside of the United States of America, its territories, or possessions, the words "Government" and "Government-furnished" (wherever they appear in this clause) shall be construed as "United States Government" and "United States Government-furnished," respectively.

(End of clause)
(R 7-104.24(a) 1968 SEP)
(R 7-104.24(b) 1968 SEP)
(R 7-104.24(d) 1968 SEP)
(R 7-303.7 1972 SEP)
(R 1-7.303-7(a))
(R 1-7.303-7(d))

Alternate I (APR 1984). As prescribed in 45.106(b)(2), substitute the following paragraph (g) for paragraph (g) of the basic clause:

(g) *Limited risk of loss.* (1) The term "Contractor's managerial personnel," as used in this paragraph (g), means the Contractor's directors, officers, and any of the Contractor's managers, superintendents, or equivalent representatives who have supervision or direction of—

(i) All or substantially all of the Contractor's business;

(ii) All or substantially all of the Contractor's operation at any one plant or separate location at which the contract is being performed; or

(iii) A separate and complete major industrial operation connected with performing this contract.

(2) The Contractor shall not be liable for loss or destruction of, or damage to, the Government property provided under this contract (or, if an educational or nonprofit organization, for expenses incidental to such loss, destruction, or damage), except as provided in subparagraphs (3) and (4) below.

(3) The Contractor shall be responsible for loss or destruction of, or damage to, the Government property provided under this contract (including expenses incidental to such loss, destruction, or damage)—

(i) That results from a risk expressly required to be insured under this contract, but only to the extent of the insurance required to be purchased and maintained, or to the extent of insurance actually purchased and maintained, whichever is greater;

(ii) That results from a risk that is in fact covered by insurance or for which the Contractor is otherwise reimbursed, but only to the extent of such insurance or reimbursement;

(iii) For which the Contractor is otherwise responsible under the express terms of this contract;

(iv) That results from willful misconduct or lack of good faith on the part of the Contractor's managerial personnel; or

(v) That results from a failure on the part of the Contractor, due to willful misconduct or lack of good faith on the part of the Contractor's managerial personnel, to establish and administer a program or system for the control, use, protection, preservation, maintenance, and repair of Government property as required by paragraph (e) of this clause.

(4) (i) If the Contractor fails to act as provided in subdivision (g)(3)(v) above, after being notified (by certified mail addressed to one of the Contractor's managerial personnel) of the Government's disapproval, withdrawal of approval, or nonacceptance of the system or program, it shall be conclusively presumed that such failure was due to willful misconduct or lack of good faith on the part of the Contractor's managerial personnel.

(ii) In such event, any loss or destruction of, or damage to, the Government property shall be presumed to have resulted from such failure unless the Contractor can establish by clear and convincing evidence that such loss, destruction, or damage—

(A) Did not result from the Contractor's failure to maintain an approved program or system; or

(B) Occurred while an approved program or system was maintained by the Contractor.

(5) If the Contractor transfers Government property to the possession and control of a subcontractor, the transfer shall not affect the liability of the Contractor for loss or destruction of, or damage to, the property as set forth above. However, the Contractor shall require the subcontractor to assume the risk of, and be responsible for, any loss or destruction of, or damage to, the property while in the subcontractor's possession or control, except to the extent that the subcontract, with the advance approval of the Contracting Officer, relieves the subcontractor from such liability. In the absence of such approval, the subcontract shall contain appropriate provisions requiring the return of all Government property in as good condition as when received, except for reasonable wear and tear or for its use in accordance with the provisions of the prime contract.

(6) Upon loss or destruction of, or damage to, Government property provided under this contract, the Contractor shall so notify the Contracting Officer and shall communicate with the loss and salvage organization, if any, designated by the Contracting Officer. With the assistance of any such organization, the Contractor shall take all reasonable action to protect the Government property from further damage, separate the damaged and undamaged Government property, put all the affected Government property in the best possible order, and furnish to the Contracting Officer a statement of—

(i) The lost, destroyed, or damaged Government property;

(ii) The time and origin of the loss, destruction, or damage;

(iii) All known interests in commingled property of which the Government property is a part; and

(iv) The insurance, if any, covering any part of or interest in such commingled property.

(7) The Contractor shall repair, renovate, and take such other action with respect to damaged Government property as the Contracting Officer directs. If the Government property is destroyed or damaged beyond practical repair, or is damaged and so commingled or combined with property of others (including the Contractor's) that separation is impractical, the Contractor may, with the approval of and subject to any conditions imposed by the Contracting Officer, sell such property for the account of the Government. Such sales may be made in order to minimize the loss to the Government, to permit the resumption of business, or to accomplish a similar purpose. The Contractor shall be entitled to an equitable adjustment in the contract price for the expenditures made in performing the obligations under this subparagraph (g)(7) in accordance with paragraph (h) of this clause. However, the Government may directly reimburse the loss and salvage organization for any of their charges. The Contracting Officer shall give due regard to the Contractor's liability under this paragraph (g) when making any such equitable adjustment.

(8) The Contractor represents that it is not including in the price and agrees it will not hereafter include in any price to the Government any charge or

reserve for insurance (including any self- insurance fund or reserve) covering loss or destruction of, or damage to, Government property, except to the extent that the Government may have expressly required the Contractor to carry such insurance under another provision of this contract.

(9) In the event the Contractor is reimbursed or otherwise compensated for any loss or destruction of, or damage to, Government property, the Contractor shall use the proceeds to repair, renovate, or replace the lost, destroyed, or damaged Government property or shall otherwise credit the proceeds to or equitably reimburse the Government, as directed by the Contracting Officer.

(10) The Contractor shall do nothing to prejudice the Government's rights to recover against third parties for any loss or destruction of, or damage to, Government property. Upon the request of the Contracting Officer, the Contractor shall, at the Government's expense, furnish to the Government all reasonable assistance and cooperation (including the prosecution of suit and the execution of instruments of assignment in favor of the Government) in obtaining recovery. In addition, where a subcontractor has not been relieved from liability for any loss or destruction of, or damage to, Government property, the Contractor shall enforce for the benefit of the Government the liability of the subcontractor for such loss, destruction, or damage.

(R 7-104.24(c) 1978 SEP)
(R 1-7.303-7(b))

Alternate II (JUL 1985). As prescribed in 45.106(b)(3), substitute the following paragraphs (c) and (g) for paragraphs (c) and (g) of the basic clause:

(c) *Title in Government property.* (1) The Government shall retain title to all Government-furnished property.

(2) All Government-furnished property and all property acquired by the Contractor, title to which vests in the Government under this paragraph (collectively referred to as "Government property"), are subject to the provisions of this clause. Title to Government property shall not be affected by its incorporation into or attachment to any property not owned by the Government, nor shall Government property become a fixture or lose its identity as personal property by being attached to any real property.

(3) Title to each item of facilities, special test equipment, and special tooling (other than that subject to a special tooling clause) acquired by the Contractor for the Government under this contract shall pass to and vest in the Government when its use in performing this contract commences, or when the Government has paid for it, whichever is earlier, whether or not title previously vested in the Government.

(4) Title to equipment (and other tangible personal property) purchased with funds available for research and having an acquisition cost of less than $5,000 shall vest in the Contractor upon acquisition or as soon thereafter as feasible; *provided*, that the Contractor obtained the Contracting Officer's approval before each acquisition. Title to equipment purchased with funds available for research and having an acquisition cost of $5,000 or more shall vest as set forth in the contract. If title to equipment vests in the Contractor under this subparagraph (c)(4), the Contractor agrees that no charge will be made to the Government for any depreciation, amortization, or use under any existing or future Government contract or subcontract thereunder. The Contractor shall furnish the Contracting Officer a list of all equipment to which title is vested in the Contractor under this subparagraph (c)(4) within 10 days following the end of the calendar quarter during which it was received.

(5) Vesting title under this paragraph (c) is subject to civil rights legislation, 42 U.S.C. 2000d. Before title is vested and by signing this contract, the Contractor accepts and agrees that—

"No person in the United States shall, on the ground of race, color, or national origin, be excluded from participation in, be denied the benefits of, or be otherwise subjected to discrimination under this contemplated financial assistance (title to equipment)."

(g) *Limited risk of loss.* (1) The term "Contractor's managerial personnel," as used in this paragraph (g), means the Contractor's directors, officers, and any of the Contractor's managers, superintendents, or equivalent representatives who have supervision or direction of—

(i) All or substantially all of the Contractor's business;

(ii) All or substantially all of the Contractor's operation at any one plant, laboratory, or separate location at which the contract is being performed; or

(iii) A separate and complete major industrial operation connected with performing this contract.

(2) The Contractor shall not be liable for loss or destruction of, or damage to, the Government property provided under this contract (or, if an educational or nonprofit organization, for expenses incidental to such loss, destruction, or damage), except as provided in subparagraphs (3) and (4) below.

(3) The Contractor shall be responsible for loss or destruction of, or damage to, the Government property provided under this contract (including expenses incidental to such loss, destruction, or damage)—

(i) That results from a risk expressly required to be insured under this contract, but only to the extent of the insurance required to be purchased and maintained, or to the extent of insurance actu-

ally purchased and maintained, whichever is greater;

(ii) That results from a risk which is in fact covered by insurance or for which the Contractor is otherwise reimbursed, but only to the extent of such insurance or reimbursement;

(iii) For which the Contractor is otherwise responsible under the express terms of this contract;

(iv) That results from willful misconduct or lack of good faith on the part of the Contractor's managerial personnel; or

(v) That results from a failure on the part of the Contractor, due to willful misconduct or lack of good faith on the part of the Contractor's managerial personnel, to establish and administer a program or system for the control, use, protection, preservation, maintenance, and repair of Government property as required by paragraph (e) of this clause.

(4) (i) If the Contractor fails to act as provided in subdivision (g)(3)(v) above, after being notified (by certified mail adressed to one of the Contractor's managerial personel) of the Government's disapproval, withdrawal of approval, or nonacceptance of the system or program, it shall be conclusively presumed that such failure was due to willful misconduct or lack of good faith on the part of the Contractor's managerial personnel.

(ii) Furthermore, any loss or destruction of, or damage to, the Government property shall be presumed to have resulted from such failure unless the Contractor can establish by clear and convincing evidence that such loss, destruction, or damage—

(A) Did not result from the Contractor's failure to maintain an approved program or system; or

(B) Occurred while an approved program or system was maintained by the Contractor.

(5) If the Contractor transfers Government property to the possession and control of a subcontractor, the transfer shall not affect the liability of the Contractor for loss or destruction of, or damage to, the property as set forth above. However, the Contractor shall require the subcontractor to assume the risk of, and be responsible for, any loss or destruction of, or damage to, the property while in the subcontractor's possession or control, except to the extent that the subcontract, with the advance approval of the Contracting Officer, relieves the subcontractor from such liability. In the absence of such approval, the subcontract shall contain appropriate provisions requiring the return of all Government property in as good condition as when received, except for reasonable wear and tear or for its use in accordance with the provisions of the prime contract.

(6) Upon loss or destruction of, or damage to, Government property provided under this contract, the Contractor shall so notify the Contracting Officer and shall communicate with the loss and salvage organization, if any, designated by the Contracting Officer. With the assistance of any such organization, the Contractor shall take all reasonable action to protect the Government property from further damage, separate the damaged and undamaged Government property, put all the affected Government property in the best possible order, and furnish to the Contracting Officer a statement of—

(i) The lost, destroyed, or damaged Government property;

(ii) The time and origin of the loss, destruction, or damage;

(iii) All known interests in commingled property of which the Government property is a part; and

(iv) The insurance, if any, covering any part of or interest in such commingled property.

(7) The Contractor shall repair, renovate, and take such other action with respect to damaged Government property as the Contracting Officer directs. If the Government property is destroyed or damaged beyond practical repair, or is damaged and so commingled or combined with property of others (including the Contractor's) that separation is impractical, the Contractor may, with the approval of and subject to any conditions imposed by the Contracting Officer, sell such property for the account of the Government. Such sales may be made in order to minimize the loss to the Government, to permit the resumption of business, or to accomplish a similar purpose. The Contractor shall be entitled to an equitable adjustment in the contract price for the expenditures made in performing the obligations under this subparagraph (g)(7) in accordance with paragraph (h) of this clause. However, the Government may directly reimburse the loss and salvage organization for any of their charges. The Contracting Officer shall give due regard to the Contractor's liability under this paragraph (g) when making any such equitable adjustment.

(8) The Contractor represents that it is not including in the price, and agrees it will not hereafter include in any price to the Government, any charge or reserve for insurance (including any self-insurance fund or reserve) covering loss or destruction of, or damage to, Government property, except to the extent that the Government may have expressly required the Contractor to carry such insurance under another provision of this contract.

(9) In the event the Contractor is reimbursed or otherwise compensated for any loss or destruction of, or damage to, the Government property, the Contractor shall use the proceeds to repair, renovate, or replace the lost, destroyed, or damaged Government property or shall otherwise credit the proceeds

to or equitably reimburse the Government, as directed by the Contracting Officer

(10) The Contractor shall do nothing to prejudice the Government's rights to recover against third parties for any loss or destruction of, or damage to, Government property. Upon the request of the Contracting Officer, the Contractor shall, at the Government's expense, furnish to the Government all reasonable assistance and cooperation (including the prosecution of suit and the execution of instruments of assignment in favor of the Government) in obtaining recovery. In addition, where a subcontractor has not been relieved from liability for any loss or destruction of, or damage to, Government property, the Contractor shall enforce for the benefit of the Government the liability of the subcontractor for such loss, destruction, or damage.

52.245-3 Identification of Government-Furnished Property.

As prescribed in 45.106(c), insert the following clause, in addition to the clause at 52.245-2, Government Property (Fixed-Price Contracts), in solicitations and contracts when a fixed-price construction contract is contemplated under which the Government is to furnish Government property f.o.b. railroad cars at a specified destination or f.o.b. truck at the project site. The contract Schedule shall specify the point of delivery and may include special terms and conditions covering installation, preparation for operation, or equipment testing by the Government or by another contractor.

IDENTIFICATION OF GOVERNMENT-FURNISHED PROPERTY (APR 1984)

(a) The Government will furnish to the Contractor the property identified in the Schedule to be incorporated or installed into the work or used in performing the contract. The listed property will be furnished f.o.b. railroad cars at the place specified in the contract Schedule or f.o.b. truck at the project site. The Contractor is required to accept delivery, pay any demurrage or detention charges, and unload and transport the property to the job site at its own expense. When the property is delivered, the Contractor shall verify its quantity and condition and acknowledge receipt in writing to the Contracting Officer. The Contractor shall also report in writing to the Contracting Officer within 24 hours of delivery any damage to or shortage of the property as received. All such property shall be installed or incorporated into the work at the expense of the Contractor, unless otherwise indicated in this contract.

(b) Each item of property to be furnished under this clause shall be identified in the Schedule by quantity, item, and description.

(End of clause)

(R 7-603.28 1968 SEP)

52.245-4 Government-Furnished Property (Short Form).

As prescribed in 45.106(d), insert the following clause:

GOVERNMENT-FURNISHED PROPERTY (SHORT FORM) (APR 1984)

(a) The Government shall deliver to the Contractor, at the time and locations stated in this contract, the Government-furnished property described in the Schedule or specifications. If that property, suitable for its intended use, is not delivered to the Contractor, the Contracting Officer shall equitably adjust affected provisions of this contract in accordance with the Changes clause when—

(1) The Contractor submits a timely written request for an equitable adjustment; and

(2) The facts warrant an equitable adjustment.

(b) Title to Government-furnished property shall remain in the Government. The Contractor shall use the Government-furnished property only in connection with this contract. The Contractor shall maintain adequate property control records in accordance with sound industrial practice and will make such records available for Government inspection at all reasonable times, unless the clause at Federal Acquisition Regulation 52.245-1, Property Records, is included in this contract.

(c) Upon delivery of Government-furnished property to the Contractor, the Contractor assumes the risk and responsibility for its loss or damage, except

(1) For reasonable wear and tear;

(2) To the extent property is consumed in performing this contract; or

(3) As otherwise provided for by the provisions of this contract.

(d) Upon completing this contract, the Contractor shall follow the instructions of the Contracting Officer regarding the disposition of all Government-furnished property not consumed in performing this contract or previously delivered to the Government. The Contractor shall prepare for shipment, deliver f.o.b. origin, or dispose of the Government property, as may be directed or authorized by the Contracting Officer. The net proceeds of any such disposal shall be credited to the contract price or shall be paid to the Government as directed by the Contracting Officer.

(e) If this contract is to be performed outside the United States of America, its territories, or possessions, the words "Government" and "Government-furnished" (wherever they appear in this clause) shall be construed

as "United States Government" and "United States Government-furnished," respectively.

(End of clause)

(R 7-104.24(f) 1964 NOV)

52.245-5 Government Property (Cost-Reimbursement, Time-and-Material, or Labor-Hour Contracts).

As prescribed in 45.106(f)(1), insert the following clause:

GOVERNMENT PROPERTY (COST-REIMBURSEMENT, TIME-AND-MATERIAL, OR LABOR-HOUR CONTRACTS) (JAN 1986)

(a) *Government-furnished property.* (1) The term "Contractor's managerial personnel," as used in paragraph (g) of this clause, means any of the Contractor's directors, officers, managers, superintendents, or equivalent representatives who have supervision or direction of--

(i) All or substantially all of the Contractor's business;

(ii) All or substantially all of the Contractor's operation at any one plant, or separate location at which the contract is being performed; or

(iii) A separate and complete major industrial operation connected with performing this contract.

(2) The Government shall deliver to the Contractor, for use in connection with and under the terms of this contract, the Government-furnished property described in the Schedule or specifications, together with such related data and information as the Contractor may request and as may be reasonably required for the intended use of the property (hereinafter referred to as "Government-furnished property").

(3) The delivery or performance dates for this contract are based upon the expectation that Government-furnished property suitable for use will be delivered to the Contractor at the times stated in the Schedule or, if not so stated, in sufficient time to enable the Contractor to meet the contract's delivery or performance dates.

(4) If Government-furnished property is received by the Contractor in a condition not suitable for the intended use, the Contractor shall, upon receipt, notify the Contracting Officer, detailing the facts, and, as directed by the Contracting Officer and at Government expense, either effect repairs or modification or return or otherwise dispose of the property. After completing the directed action and upon written request of the Contractor, the Contracting Officer shall make an equitable adjustment as provided in paragraph (h) of this clause.

(5) If Government-furnished property is not delivered to the Contractor by the required time or times, the Contracting Officer shall, upon the Contractor's timely written request, make a determination of the delay, if any, caused the Contractor and shall make an equitable adjustment in accordance with paragraph (h) of this clause.

(b) *Changes in Government-furnished property.* (1) The Contracting Officer may, by written notice, (i) decrease the Government-furnished property provided or to be provided under this contract or (ii) substitute other Government-furnished property for the property to be provided by the Government or to be acquired by the Contractor for the Government under this contract. The Contractor shall promptly take such action as the Contracting Officer may direct regarding the removal, shipment, or disposal of the property covered by this notice.

(2) Upon the Contractor's written request, the Contracting Officer shall make an equitable adjustment to the contract in accordance with paragraph (h) of this clause, if the Government has agreed in the Schedule to make such property available for performing this contract and there is any—

(i) Decrease or substitution in this property pursuant to subparagraph (b)(1) above; or

(ii) Withdrawal of authority to use property, if provided under any other contract or lease.

(c) *Title.* (1) The Government shall retain title to all Government-furnished property.

(2) Title to all property purchased by the Contractor for which the Contractor is entitled to be reimbursed as a direct item of cost under this contract shall pass to and vest in the Government upon the vendor's delivery of such property.

(3) Title to all other property, the cost of which is reimbursable to the Contractor, shall pass to and vest in the Government upon—

(i) Issuance of the property for use in contract performance;

(ii) Commencement of processing of the property or use in contract performance; or

(iii) Reimbursement of the cost of the property by the Government, whichever occurs first.

(4) All Government-furnished property and all property acquired by the Contractor, title to which vests in the Government under this paragraph (collectively referred to as "Government property"), are subject to the provisions of this clause. Title to Government property shall not be affected by its incorporation into or attachment to any property not owned by the Government, nor shall Government property become a fixture or lose its identity as per-

sonal property by being attached to any real property.

(d) *Use of Government property.* The Government property shall be used only for performing this contract, unless otherwise provided in this contract or approved by the Contracting Officer.

(e) *Property administration.* (1) The Contractor shall be responsible and accountable for all Government property provided under the contract and shall comply with Federal Acquisition Regulation (FAR) Subpart 45.5, as in effect on the date of this contract.

(2) The Contractor shall establish and maintain a program for the use, maintenance, repair, protection, and preservation of Government property in accordance with sound business practice and the applicable provisions of FAR Subpart 45.5.

(3) If damage occurs to Government property, the risk of which has been assumed by the Government under this contract, the Government shall replace the items or the Contractor shall make such repairs as the Government directs. However, if the Contractor cannot effect such repairs within the time required, the Contractor shall dispose of the property as directed by the Contracting Officer. When any property for which the Government is responsible is replaced or repaired, the Contracting Officer shall make an equitable adjustment in accordance with paragraph (h) of this clause.

(f) *Access.* The Government and all its designees shall have access at all reasonable times to the premises in which any Government property is located for the purpose of inspecting the Government property.

(g) *Limited risk of loss.* (1) The Contractor shall not be liable for loss or destruction of, or damage to, the Government property provided under this contract or for expenses incidental to such loss, destruction, or damage, except as provided in subparagraphs (2) and (3) below.

(2) The Contractor shall be responsible for loss or destruction of, or damage to, the Government property provided under this contract (including expenses incidental to such loss, destruction, or damage)—

(i) That results from a risk expressly required to be insured under this contract, but only to the extent of the insurance required to be purchased and maintained or to the extent of insurance actually purchased and maintained, whichever is greater;

(ii) That results from a risk that is in fact covered by insurance or for which the Contractor is otherwise reimbursed, but only to the extent of such insurance or reimbursement;

(iii) For which the Contractor is otherwise responsible under the express terms of this contract;

(iv) That results from willful misconduct or lack of good faith on the part of the Contractor's managerial personnel; or

(v) That results from a failure on the part of the Contractor, due to willful misconduct or lack of good faith on the part of the Contractor's managerial personnel, to establish and administer a program or system for the control, use, protection, preservation, maintenance, and repair of Government property as required by paragraph (e) of this clause.

(3) (i) If the Contractor fails to act as provided by subdivision (g)(2)(v) above, after being notified (by certified mail addressed to one of the Contractor's managerial personnel) of the Government's disapproval, withdrawal of approval, or nonacceptance of the system or program, it shall be conclusively presumed that such failure was due to willful misconduct or lack of good faith on the part of the Contractor's managerial personnel.

(ii) In such event, any loss or destruction of, or damage to, the Government property shall be presumed to have resulted from such failure unless the Contractor can establish by clear and convincing evidence that such loss, destruction, or damage—

(A) Did not result from the Contractor's failure to maintain an approved program or system; or

(B) Occurred while an approved program or system was maintained by the Contractor.

(4) If the Contractor transfers Government property to the possession and control of a subcontractor, the transfer shall not affect the liability of the Contractor for loss or destruction of, or damage to, the property as set forth above. However, the Contractor shall require the subcontractor to assume the risk of, and be responsible for, any loss or destruction of, or damage to, the property while in the subcontractor's possession or control, except to the extent that the subcontract, with the advance approval of the Contracting Officer, relieves the subcontractor from such liability. In the absence of such approval, the subcontract shall contain appropriate provisions requiring the return of all Government property in as good condition as when received, except for reasonable wear and tear or for its use in accordance with the provisions of the prime contract.

(5) Upon loss or destruction of, or damage to, Government property provided under this contract, the Contractor shall so notify the Contracting Officer and shall communicate with the loss and salvage organization, if any, designated by the Contracting Officer. With the assistance of any such organization, the Contractor shall take all reasonable action to protect the Government property from further damage, separate the damaged and undamaged Government property, put all the affected Government property in the best possible order, and furnish to the Contracting Officer a statement of—

(i) The lost, destroyed, or damaged Government property;

(ii) The time and origin of the loss, destruction, or damage;

(iii) All known interests in commingled property of which the Government property is a part; and

(iv) The insurance, if any, covering any part of or interest in such commingled property.

(6) The Contractor shall repair, renovate, and take such other action with respect to damaged Government property as the Contracting Officer directs. If the Government property is destroyed or damaged beyond practical repair, or is damaged and so commingled or combined with property of others (including the Contractor's) that separation is impractical, the Contractor may, with the approval of and subject to any conditions imposed by the Contracting Officer, sell such property for the account of the Government. Such sales may be made in order to minimize the loss to the Government, to permit the resumption of business, or to accomplish a similar purpose. The Contractor shall be entitled to an equitable adjustment in the contract price for the expenditures made in performing the obligations under this subparagraph (g)(6) in accordance with paragraph (h) of this clause. However, the Government may directly reimburse the loss and salvage organization for any of their charges. The Contracting Officer shall give due regard to the Contractor's liability under this paragraph (g) when making any such equitable adjustment.

(7) The Contractor shall not be reimbursed for, and shall not include as an item of overhead, the cost of insurance or of any reserve covering risk of loss or destruction of, or damage to, Government property, except to the extent that the Government may have expressly required the Contractor to carry such insurance under another provision of this contract.

(8) In the event the Contractor is reimbursed or otherwise compensated for any loss or destruction of, or damage to, Government property, the Contractor shall use the proceeds to repair, renovate, or replace the lost, destroyed, or damaged Government property or shall otherwise credit the proceeds to, or equitably reimburse, the Government, as directed by the Contracting Officer.

(9) The Contractor shall do nothing to prejudice the Government's rights to recover against third parties for any loss or destruction of, or damage to, Government property. Upon the request of the Contracting Officer, the Contractor shall, at the Government's expense, furnish to the Government all reasonable assistance and cooperation (including the prosecution of suit and the execution of instruments of assignment in favor of the Government) in obtaining recovery. In addition, where a subcontractor has not been relieved from liability for any loss or destruction of, or damage to, Government property, the Contractor shall enforce for the benefit of the Government the liability of the subcontractor for such loss, destruction, or damage.

(h) *Equitable adjustment.* When this clause specifies an equitable adjustment, it shall be made to any affected contract provision in accordance with the procedures of the Changes clause. When appropriate, the Contracting Officer may initiate an equitable adjustment in favor of the Government. The right to an equitable adjustment shall be the Contractor's exclusive remedy. The Government shall not be liable to suit for breach of contract for—

(1) Any delay in delivery of Government-furnished property;

(2) Delivery of Government-furnished property in a condition not suitable for its intended use;

(3) A decrease in or substitution of Government-furnished property; or

(4) Failure to repair or replace Government property for which the Government is responsible.

(i) *Final accounting and disposition of Government property.* Upon completing this contract, or at such earlier dates as may be fixed by the Contracting Officer, the Contractor shall submit, in a form acceptable to the Contracting Officer, inventory schedules covering all items of Government property not consumed in performing this contract or delivered to the Government. The Contractor shall prepare for shipment, deliver f.o.b. origin, or dispose of the Government property as may be directed or authorized by the Contracting Officer. The net proceeds of any such disposal shall be credited to the cost of the work covered by this contract or paid to the Government as directed by the Contracting Officer. The foregoing provisions shall apply to scrap from Government property; *provided*, however, that the Contracting Officer may authorize or direct the Contractor to omit from such inventory schedules any scrap consisting of faulty castings or forgings or of cutting and processing waste, such as chips, cuttings, borings, turnings, short ends, circles, trimmings, clippings, and remnants, and to dispose of such scrap in accordance with the Contractor's normal practice and account for it as a part of general overhead or other reimbursable costs in accordance with the Contractor's established accounting procedures.

(j) *Abandonment and restoration of Contractor premises.* Unless otherwise provided herein, the Government—

(1) May abandon any Government property in place, at which time all obligations of the Government regarding such abandoned property shall cease; and

(2) Has no obligation to restore or rehabilitate the Contractor's premises under any circumstances (e.g., abandonment, disposition upon completion of need, or contract completion). However, if the Government-furnished property (listed in the Schedule or

specifications) is withdrawn or is unsuitable for the intended use, or if other Government property is substituted, then the equitable adjustment under paragraph (h) of this clause may properly include restoration or rehabilitation costs.

(k) *Communications.* All communications under this clause shall be in writing.

(l) *Overseas contracts.* If this contract is to be performed outside the United States of America, its territories, or possessions, the words "Government" and "Government-furnished" (wherever they appear in this clause) shall be construed as "United States Government" and "United States Government-furnished," respectively.

(End of clause)

Alternate I (JUL 1985). As prescribed in 45.302-6(e)(2), substitute the following paragraph (c) for paragraph (c) of the basic clause:

(c) *Title.* (1) The Government shall retain title to all Government-furnished property.

(2) All Government-furnished property and all property acquired by the Contractor, title to which vests in the Government under this paragraph (collectively referred to as "Government property"), are subject to the provisions of this clause. Title to Government property shall not be affected by its incorporation into or attachment to any property not owned by the Government, nor shall Government property become a fixture or lose its identity as personal property by being attached to any real property.

(3) Title to all property purchased by the Contractor for which the Contractor is entitled to be reimbursed as a direct item of cost under this contract and that, under the provisions of this contract is to vest in the Government, shall pass to and vest in the Government upon the vendor's delivery of such property. Title to all other property, the cost of which is to be reimbursed to the Contractor under this contract and that under the provisions of this contract is to vest in the Government, shall pass to and vest in the Government upon—

(i) Issuance of the property for use in contract performance;

(ii) Commencement of processing of the property or its use in contract performance; or

(iii) Reimbursement of the cost of the property by the Government, whichever occurs first.

(4) Title to equipment (and other tangible personal property) purchased with funds available for research and having an acquisition cost of less than $5,000 shall vest in the Contractor upon acquisition or as soon thereafter as feasible; *provided*, that the Contractor obtained the Contracting Officer's approval before each acquisition. Title to equipment purchased with funds available for research and having an acquisition cost of $5,000 or more shall vest as set forth in the contract. If title to equipment vests in the Contractor under this subparagraph (c)(4), the Contractor agrees that no charge will be made to the Government for any depreciation, amortization, or use under any existing or future Government contract or subcontract thereunder. The Contractor shall furnish the Contracting Officer a list of all equipment to which title is vested in the Contractor under this subparagraph (c)(4) within 10 days following the end of the calendar quarter during which it was received.

(5) Vesting title under this paragraph (c) is subject to civil rights legislation, 42 U.S.C. 2000d. Before title is vested and by signing this contract, the Contractor accepts and agrees that—

"No person in the United States shall, on the ground of race, color, or national origin, be excluded from participation in, be denied the benefits of, or be otherwise subjected to discrimination under this contemplated financial assistance (title to equipment)."

52.245-6 Liability for Government Property (Demolition Services Contracts).

As prescribed in 45.106(g) insert the following clause, in addition to the clauses prescribed at 37.304, in solicitations and contracts for dismantling, demolition, or removal of improvements:

LIABILITY FOR GOVERNMENT PROPERTY (DEMOLITION SERVICES CONTRACTS) (APR 1984)

Except for reasonable wear and tear incident to removal and delivery to the Government, the Contractor assumes the risk of and shall be responsible for any loss or destruction of, or damage to, items of property, title to which—

(a) Remains in the Government and that are to be delivered to the Government by the Contractor in performing the work; and

(b) Is vested in the Contractor but that under the Termination clauses of this contract is revested in the Government upon notice of termination.

(End of clause)

(R 7-2101.16 1976 OCT)

52.245-7 Government Property (Consolidated Facilities).

As prescribed in 45.302-6(a), insert the following clause in solicitations and contracts when a consolidated facilities contract is contemplated:

GOVERNMENT PROPERTY (CONSOLIDATED

FACILITIES) (APR 1984)

(a) *Definitions.* For the purpose of this contract, the following definitions apply:

"Facilities," as used in this clause, means all property provided under this facilities contract.

"Related contract," as used in this clause, means a Government contract or subcontract for supplies or services under which the use of the facilities is or may be authorized.

(b) *Facilities to be provided.* (1) The Contractor, at Government expense and subject to the provisions of this contract, shall acquire, construct, or install the facilities and perform the related work as described in the Schedule.

(2) The Government, subject to the provisions of this contract, shall furnish to the Contractor the facilities identified in the Schedule as Government-furnished facilities. The Contractor, at Government expense, shall perform the work with respect to those facilities as is described in the Schedule.

(3) All shipments of the facilities shall be made on Government bills of lading, unless otherwise authorized by the Contracting Officer. The required number of such Government bills of lading will be furnished to the Contractor by, and the Contractor shall be accountable therefor to, the transportation activity designated by the Contracting Officer.

(c) *Period of this contract.* If not otherwise specified in the contract and if not previously terminated under paragraph (m), the use of the facilities authorized under this contract shall terminate 5 years after its effective date. Thereafter, if continued use of the facilities by the Contractor is mutually desired, the parties shall enter into a new contract that shall incorporate such provisions as may then be required by applicable laws and regulations. The parties may, by written agreement, extend the use of the facilities under this contract beyond this 5-year period to permit the completion of any then-existing related contracts and subcontracts.

(d) *Title in the facilities.* (1) The Government shall retain title to all Government-furnished property.

(2) Title to all facilities and components shall pass to and vest in the Government upon delivery by the vendor of all such items purchased by the Contractor for which it is entitled to be reimbursed as a direct item of cost under this contract.

(3) Title to replacement parts furnished by the Contractor in carrying out its normal maintenance obligations under paragraph (h) shall pass to and vest in the Government upon completion of their installation in the facilities.

(4) Title to other property, the cost of which is reimbursable to the Contractor under this contract, shall pass to and vest in the Government upon—

(i) Issuance of the property for use in performing this contract;

(ii) Commencement of processing or use of the property in performing this contract; or

(iii) Reimbursement of the cost of the property by the Government, whichever occurs first.

(5) Title to the facilities shall not be affected by their incorporation into or attachment to any property not owned by the Government, nor shall any item of the facilities become a fixture or lose its identity as personal property by being attached to any real property. The Contractor shall keep the facilities free and clear of all liens and encumbrances and, except as otherwise authorized by this contract or by the Contracting Officer, shall not remove or otherwise part with possession of, or permit the use by others of, any of the facilities.

(6) The Contractor may, with the written approval of the Contracting Officer, install, arrange, or rearrange, on Government-furnished premises, readily movable machinery, equipment, and other items belonging to the Contractor. Title to any such item shall remain in the Contractor even though it may be attached to real property owned by the Government, unless the Contracting Officer determines that it is so permanently attached that removal would cause substantial injury to Government property.

(7) The Contractor shall not construct or install, at its own expense, any fixed improvement or structural alterations in Government buildings or other real property without advance written approval of the Contracting Officer. Fixed improvement or structural alterations, as used herein, means any alteration or improvement in the nature of the building or other real property, that, after completion, cannot be removed without substantial loss of value or damage to the premises. The term does not include foundations for production equipment.

(e) *Location of the facilities.* The Contractor may use the facilities at any of the locations specified in the Schedule and, with the prior written approval of the Contracting Officer, at any other location. In granting this approval, the Contracting Officer may prescribe such terms and conditions as may be deemed necessary for protecting the Government's interest in the facilities involved. Those terms and conditions shall take precedence over any conflicting provisions of this contract.

(f) *Notice of use of the facilities.* The Contractor shall notify the Contracting Officer in writing—

(1) Whenever use of all facilities for Government work in any quarterly period averages less than 75 percent of the total use of the facilities; or

(2) Whenever any item of the facilities is no longer needed or usable for performing existing related contracts that authorize such use.

(g) *Property control.* The Contractor shall maintain property control procedures and records and a system of identification of the facilities, in accordance with the provisions of Federal Acquisition Regulation (FAR) Subpart 45.5 in effect on the date of this contract. The

provisions of FAR 45.5 are hereby incorporated by reference and made a part of this contract.

(h) *Maintenance.* (1) Except as otherwise provided in the Schedule, the Contractor shall perform normal maintenance of the facilities in accordance with sound industrial practice, including protection, preservation, and repair of the facilities and normal parts replacement for equipment.

(2) As soon as practicable after the execution of this contract, the Contractor shall submit to the Contracting Officer a written proposed maintenance program, including a maintenance records system, in sufficient detail to show its adequacy. If the Contracting Officer agrees to the proposed program, it shall become the normal maintenance obligation of the Contractor. The Contractor's performance according to the approved program shall satisfy the Contractor's obligations under subparagraphs (h)(1) and (h)(5) of this clause.

(3) The Contracting Officer may at any time direct the Contractor in writing to reduce the work required by the normal maintenance program. If such order reduces the cost of performing the maintenance, an appropriate equitable adjustment may be made in any affected related contract that so provides.

(4) The Contractor shall perform any maintenance work directed by the Contracting Officer in writing. Work in excess of the maintenance required under subparagraphs (h)(1) through (h)(3) of this clause shall be at Government expense. The Contractor shall notify the Contracting Officer in writing when sound industrial practice requires maintenance in excess of the normal maintenance program.

(5) The Contractor shall keep records of all work done on the facilities and shall give the Government reasonable opportunity to inspect these records. When facilities are disposed of under this contract, the Contractor shall deliver the related records to the Government or, if the Contracting Officer directs, to third persons.

(6) The Contractor's obligation under this clause for each item of facilities shall continue until the item is removed, abandoned, or disposed of; until the expiration of the 120-day period stated in subparagraph (n)(4) of this clause; and until the Contractor has discharged its other obligations under this contract with respect to such items.

(i) *Access.* The Government and any persons designated by it shall, at all reasonable times, have access to the premises where any of the facilities are located.

(j) *Indemnification of the Government.* The Contractor shall indemnify the Government and hold it harmless against claims for injury to persons or damage to property of the Contractor or others arising from the Contractor's possession or use of the facilities, except as specified in the clause at FAR 52.228-6, Insurance—Liability to Third Persons, or at FAR 52.228-7, Liability to Third Persons—Total Immunity. However, the provisions of the Contractor's related contracts shall govern any assumption of liability by the Government for claims arising under those contracts.

(k) *Late delivery, diversion, and substitution.* (1) The Government shall not be liable for breach of contract for any delay in delivery or nondelivery of facilities to be furnished under this contract.

(2) The Government has the right, at its expense, to divert the facilities under this contract by directing the Contractor to—

(i) Deliver any of the facilities to locations other than those specified in the Schedule; or

(ii) Assign purchase orders or subcontracts for any of the facilities to the Government or third parties.

(3) The Government may furnish any facilities instead of having the Contractor acquire or construct them. In such event, the Contractor is entitled to reimbursement for the cost related to the acquisition or construction of the facilities, including the cost of terminating purchase orders and subcontracts.

(4) Appropriate equitable adjustment may be made in any related contract that so provides and that is affected by any nondelivery, delay, diversion, or substitution under this paragraph (k).

(l) *Representations and warranties.* (1) The Government makes no warranty, express or implied, regarding the condition or fitness for use of any facilities. To the extent practical, the Contractor shall be allowed to inspect all the facilities to be furnished by the Government before their shipment.

(2) If the Contractor receives facilities in a condition not suitable for the intended use, the Contractor shall, within 30 days after receipt and installation thereof, so notify the Contracting Officer, detailing the facts and, as directed by the Contracting Officer and at Government expense, either (i) return such item or otherwise dispose of it or (ii) effect repairs or modifications. An appropriate equitable adjustment may be made in any related contract that so provides and that is affected by the return, disposition, repair, or modification of any facilities.

(m) *Termination of the use of the facilities.* (1) The Contractor may at any time, upon written notice to the Contracting Officer, terminate its authority to use any or all of the facilities. Termination under this paragraph (m) shall not relieve the Contractor of any of its obligations or liabilities under any related contract or subcontract affected by the termination.

(2) The Contracting Officer may at any time, upon written notice, terminate or limit the Contractor's authority to use any of the facilities. Except as otherwise provided in the Failure to Perform clause of this contract, an equitable adjustment may be made in any related contract of the Contractor that so provides and that is affected by such notice.

(n) *Disposition of the facilities.* (1) The provisions of this paragraph (n) shall apply to facilities for which use has been terminated by either the Contracting Officer or the Contractor under paragraph (m), except as provided in subparagraph (n)(2).

(2) Unless otherwise directed by the Contracting Officer, this paragraph shall not apply to facilities terminated by the Contractor if—

(i) The facilities terminated do not comprise all of the facilities in the possession of the Contractor; and

(ii) The Contracting Officer determines that continued retention of the facilities will not interfere with the Contractor's operations.

(3) Within 60 days after the effective date of any notice of termination given under paragraph (m), or within such longer period as the Contracting Officer may approve in writing, the Contractor shall submit to the Contracting Officer, in a form satisfactory to the Contracting Officer, an accounting for all the facilities covered by the notice.

(4) Within 120 days after the Contractor accounts for any facilities under subparagraph (n)(3), the Contracting Officer shall give written notice to the Contractor as to the disposition of the facilities, except as otherwise provided in subparagraph (n)(6). In its disposition of the facilities, the Government may either—

(i) Abandon the facilities in place, in which case all obligations of the Government regarding such abandoned facilities and the restoration or rehabilitation of the premises in and on which they are located shall immediately cease; or

(ii) Require the Contractor to comply, at Government expense, with such directions as the Contracting Officer may give with respect to—

(A) The preparation, protection, removal, or shipment of the affected facilities;

(B) The retention or storage of the affected facilities; *provided*, that the Contracting Officer shall not direct the Contractor to retain or store any items of facilities in or on real property not owned by the Government if such retention or storage will interfere with the Contractor's operations;

(C) The restoration of Government-owned property incident to the removal of the facilities from such property; and

(D) The sale of any affected facilities in such manner, at such times, and at such price as may be approved by the Government, except that the Contractor shall not be required to extend credit to any purchaser.

(5) If the Contracting Officer fails to give the written notice required by subparagraph (n)(4) within the prescribed 120-day period, the Contractor may, upon not less than 30 days' written notice to the Government and at Government risk and expense, (i) retain the facilities in place or (ii) remove any of the affected severable facilities located in Contractor-owned property and store them at the Contractor's plant or in a public insured warehouse, in accordance with sound practice and in a manner compatible with their security classification. Except as provided in this subparagraph, the Government shall not be liable to the Contractor for failure to give the written notice required by subparagraph (n)(4).

(6) Nonseverable items of the facilities or items of the facilities subject to patent or proprietary rights shall be disposed of in such manner as the parties may have agreed to in writing.

(7) The Government, either directly or by third persons engaged by it, may remove or otherwise dispose of any facilities for which the Contractor's authority to use has been terminated, other than those for which specific provision is made in subparagraph (n)(6).

(8) The Contractor shall, within a reasonable time after the expiration of the 120-day period specified in subparagraph (n)(4), remove all of its property from the Government property and take such action as the Contracting Officer may direct in writing with respect to restoring that Government property (to the extent that it is affected by the installation of the Contractor's property) to its condition before such installation.

(9) Unless otherwise specifically provided in this contract, the Government shall not be obligated to the Contractor to restore or rehabilitate any property at the Contractor's plant, except for restoration or rehabilitation costs caused by removal of the facilities under subdivision (n)(4)(ii). The Contractor agrees to indemnify the Government against all suits or claims for damages arising out of the Government's failure to restore or rehabilitate any property at the Contractor's plant or property of its subcontractors, except any damage as may be caused by the negligence of the Government, its agents, or independent contractors.

(End of clause)

(R 7-702.1 1964 SEP)
(R 7-702.2 1964 SEP)
(R 7-702.25 1964 SEP)
(R 7-702.15 1964 SEP)
(R 7-705.7 1964 SEP)
(R 7-702.8 1964 SEP)
(AV 7-702.23 1968 JUN)
(R 7-702.17 1969 APR)
(R 7-702.14 1964 SEP)
(AV 7-702.16 1964 SEP)
(R 7-702.20 1964 SEP)
(R 7-702.3 1964 SEP)
(R 7-702.5 1964 SEP)
(AV 7-702.24 1964 SEP)
(R 7-702.26 1968 APR)

52.245-8 Liability for the Facilities.

As prescribed in 45.302-6(b), insert the following clause in solicitations and contracts when a consolidated facilities contract, a facilities acquisition contract, or a facilities use contract is contemplated.

LIABILITY FOR THE FACILITIES (APR 1984)

(a) The term "Contractor's managerial personnel," as used in this clause, means any of the Contractor's directors, officers, managers, superintendents, or equivalent representatives who have supervision or direction of—

(1) All or substantially all of the Contractor's business;

(2) All or substantially all of the Contractor's operations at any one plant or separate location in which the facilities are installed or located; or

(3) A separate and complete major industrial operation in connection with which the facilities are used.

(b) The Contractor shall not be liable for any loss or destruction of, or damage to, the facilities, or for expenses incidental to such loss, destruction, or damage, except as provided in this clause.

(c) The Contractor shall be liable for loss or destruction of, or damage to, the facilities, and for expenses incidental to such loss, destruction, or damage—

(1) That results from a risk expressly required to be insured under this contract, but only to the extent of the insurance required to be purchased and maintained, or to the extent of insurance actually purchased and maintained, whichever is greater;

(2) That results from a risk that is in fact covered by insurance or for which the Contractor is otherwise reimbursed, but only to the extent of such insurance or reimbursement;

(3) For which the Contractor is otherwise responsible under the express terms of this contract;

(4) That results from willful misconduct or lack of good faith on the part of the Contractor's managerial personnel; or

(5) That results from a failure, due to willful misconduct or lack of good faith on the part of the Contractor's managerial personnel—

(i) To establish, maintain, and administer a system for control of the facilities in accordance with the "Property administration" paragraph of the Government Property clause; or

(ii) To maintain and administer a program for maintenance, repair, protection, and preservation of the facilities, in accordance with the "Property administration" paragraph of the Government Property clause, or to take reasonable steps to comply with any appropriate written direction that the Contracting Officer may prescribe as reasonably necessary for the protection of the facilities. If the Government Property clause does not include the "Property administration" paragraph, then the Contractor shall exercise sound industrial practice in complying with the requirements of this subdivision (c)(5)(ii).

(d) (1) If the Contractor fails to act as provided by subparagraph (c)(5) above, after being notified (by certified mail addressed to one of the Contractor's managerial personnel) of the Government's disapproval, withdrawal of approval, or nonacceptance of the system or program, it shall be conclusively presumed that such failure was due to willful misconduct or lack of good faith on the part of the Contractor's managerial personnel.

(2) Furthermore, any loss or destruction of, or damage to, the Government property shall be presumed to have resulted from such failure unless the Contractor can establish by clear and convincing evidence that such loss, destruction, or damage—

(i) Did not result from the Contractor's failure to maintain an approved program or system; or

(ii) Occurred while an approved program or system was maintained by the Contractor.

(e) If the Contractor transfers facilities to the possession and control of a subcontractor, the transfer shall not affect the liability of the Contractor for loss or destruction of, or damage to, the facilities. However, the Contractor shall require the subcontractor to assume the risk of, and be responsible for, any loss or destruction of, or damage to, the facilities while in the subcontractor's possession or control, except to the extent that the subcontract, with the advance approval of the Contracting Officer, relieves the subcontractor from such liability. In the absence of such approval, the subcontract shall contain appropriate provisions requiring the return of all the facilities in as good condition as when received, except for reasonable wear and tear or for their utilization in accordance with the provisions of the prime contract.

(f) Unless expressly directed in writing by the Contracting Officer, the Contractor shall not include in the price or cost under any contract with the Government the cost of insurance (including self-insurance) against any form of loss, destruction, or damage to the facilities. Any insurance required under this clause shall be in such form, in such amounts, for such periods of time, and with such insurers (including the Contractor as self-insurer in appropriate circumstances) as the Contracting Officer shall require or approve. Such insurance shall provide for 30 days advance notice to the Contracting Officer, in the event of cancellation or material change in the policy coverage on the part of the insurer. A certificate of insurance or a certified copy of such insurance shall be deposited promptly with the Contracting Officer. The Contractor shall, not less than 30 days before the expiration of such insurance, deliver to the Contracting Officer a certificate of insurance or a certified copy of each renewal policy. The insurance shall be in the name of the United States of America (Agency Name), the Contractor, and such

other interested parties as the Contracting Officer shall approve, and shall contain a loss payable clause reading substantially as follows:

"Any loss under this policy shall be adjusted with (Contractor) and the proceeds, at the direction of the Government, shall be paid to (Contractor). Proceeds not paid to (Contractor) shall be paid to the office designated by the Contracting Officer."

(g) When there is any loss or destruction of, or damage to, the facilities—

(1) The Contractor shall promptly notify the Contracting Officer and, with the assistance of the Contracting Officer, shall take all reasonable steps to protect the facilities from further damage, separate the damaged and undamaged facilities, put all the facilities in the best possible order, and promptly furnish to the Contracting Officer (and in any event within 30 days) a statement of—

(i) The facilities lost or damaged;

(ii) The time and origin of the loss or damage;

(iii) All known interests in commingled property of which the facilities are a part; and

(iv) Any insurance covering any part of or interest in such commingled property;

(2) The Contractor shall make such repairs, replacements, and renovations of the lost, destroyed, or damaged facilities, or take such other action as the Contracting Officer may direct in writing; and

(3) The Contractor shall perform its obligations under this paragraph (g) at Government expense, except to the extent that the Contractor is liable for such damage, destruction, or loss under the terms of this clause, and except as any damage, destruction, or loss is compensated by insurance.

(h) The Government is not obliged to replace or repair the facilities that have been lost, destroyed, or damaged. If the Government does not replace or repair the facilities, the right of the parties to an equitable adjustment in delivery or performance dates, price, or both, and in any other contractual condition of the related contracts affected shall be governed by the terms and conditions of those contracts.

(i) Except to the extent of any loss or destruction of, or damage to, the facilities for which the Contractor is relieved of liability, the facilities shall be returned to the Government or otherwise disposed of under the terms of this contract (1) in as good condition as when received by the Contractor, (2) improved, or (3) as required under the terms of this contract, less ordinary wear and tear.

(j) If the Contractor is in any way compensated (excepting proceeds from use and occupancy insurance, the cost of which is not borne directly or indirectly by the Government) for any loss or destruction of, or damage to, the facilities, the Contractor, as directed by the Contracting Officer, shall—

(1) Use the proceeds to repair, renovate, or replace the facilities involved; or

(2) Pay such proceeds to the Government.

(k) The Contractor shall do nothing to prejudice the Government's right to recover against third parties for any loss or destruction of, or damage to, the facilities. Upon the request of the Contracting Officer, the Contractor shall furnish to the Government, at Government expense, all reasonable assistance and cooperation (including the prosecution of suit and the execution of instruments of assignment in favor of the Government) in obtaining recovery.

(End of clause)

(R 7-702.18 1976 OCT)

52.245-9 Use and Charges.

As prescribed in 45.302-6(c), insert the following clause in solicitations and contracts (1) when a consolidated facilities contract or a facilities use contract or (2) when a fixed-price contract is contemplated, and Government production and research property is provided other than on a rent-free basis. If the conditions specified in 45.403(a) apply, the contracting officer shall modify the clause, as appropriate.

USE AND CHARGES (APR 1984)

(a) The Contractor may use the facilities without charge in the performance of—

(1) Contracts with the Government that specifically authorize such use without charge;

(2) Subcontracts of any tier under Government prime contracts if the Contracting Officer having cognizance of the prime contract (i) approves a subcontract specifically authorizing such use or (ii) otherwise authorizes such use in writing; and

(3) Other work, if the Contracting Officer specifically authorizes in writing use without charge for such work.

(b) If granted written permission by the Contracting Officer, or if it is specifically provided for in the Schedule, the Contractor may use the facilities for a rental fee for work other than that provided in paragraph (a). Authorizing such use of the facilities does not waive any rights of the Government to terminate the Contractor's right to use the facilities. The rental fee shall be determined in accordance with the following paragraphs.

(c) The following bases are or shall be established in writing for the rental computation prescribed in paragraphs (d) and (e) below in advance of any use of the facilities on a rental basis:

(1) The rental rates shall be those set forth in Table I.

(2) The acquisition cost of the facilities shall be the total cost to the Government, as determined by the Contracting Officer, and includes the cost of transportation and installation, if borne by the Government.

(i) When Government-owned special tooling or accessories are rented with any of the facilities, the acquisition cost of the facilities shall be increased

by the total cost to the Government of such tooling or accessories, as determined by the Contracting Officer.

(ii) When any of the facilities are substantially improved at Government expense, the acquisition cost of the facilities shall be increased by the increase in value that the improvement represents, as determined by the Contracting Officer.

(iii) The determinations of the Contracting Officer under this subparagraph (c)(2) shall be final.

(3) For the purpose of determining the amount of rental due under paragraph (d), the rental period shall be not less than 1 month nor more than 6 months, as approved by the Contracting Officer.

(4) For the purpose of computing any credit under paragraph (e), the unit in determining the amount of use of the facilities shall be direct labor hours, sales, hours of use, or any other unit of measure that will result in an equitable apportionment of the rental charge, as approved by the Contracting Officer.

(d) The Contractor shall compute the amount of rentals to be paid for each rental period by applying the appropriate rental rates to the acquisition cost of such facilities as may have been authorized for use in advance for the rental period.

(e) The full rental charge for each period shall be reduced by a credit. The credit equals the rental amount that would otherwise be properly allocable to the work for which the facilities were used without charge under paragraph (a). The credit shall be computed by multiplying the full rental for the rental period by a fraction in which the numerator is the amount of use of the facilities by the Contractor without charge during the period, and the denominator is the total amount of use of the facilities by the Contractor during the period.

(f) Within 90 days after the close of each rental period, the Contractor shall submit to the Contracting Officer a written statement of the use made of the facilities by the Contractor and the rental due the Government. At the same time, the Contractor shall make available such records and data as are determined by the Contracting Officer to be necessary to verify the information contained in the statement.

(g) If the Contractor fails to submit the information as required in paragraph (f) above, the Contractor shall be liable for the full rental for the period. However, if the Contractor's failure to submit was not the fault of the Contractor, the Contracting Officer shall grant to the Contractor in writing a reasonable extension of time to submit.

(h) Unless otherwise directed in writing by the Contracting Officer, the Contractor shall give priority in the use of the facilities to performing contracts and subcontracts of the Contracting Officer having cognizance of the facilities and shall not undertake any work involving the use of the facilities that would interfere with performing existing Government contracts or subcontracts.

(i) Concurrently with the submission of the written statement prescribed by paragraph (f) of this clause, the Contractor shall pay the rental due the Government under this clause. Payment shall be by check made payable to the office designated for contract administration and mailed or delivered to the Contracting Officer. Receipt and acceptance by the Government of the Contractor's check pursuant to this paragraph shall constitute an accord and satisfaction of the final amount due the Government hereunder, unless the Contractor is notified in writing within 180 days following receipt that the amount received is not regarded by the Government as the final amount due.

(j) If the Contractor uses any item of the facilities without authorization, the Contractor shall be liable for the full monthly rental, without credit, for such item for each month or part of a month in which such unauthorized use occurs; *provided*, however, that the agency head concerned may, in writing, waive the Contractor's liability for such unauthorized use if the agency head determines that without such a waiver gross inequity would result. The acceptance of any rental by the Government under this clause shall not be construed as a waiver or relinquishment of any rights it may have against the Contractor growing out of the Contractor's unauthorized use of the facilities or any other failure to perform this contract according to its terms.

TABLE I

Rental Rates

(i) For real property and associated fixtures, a fair and reasonable rental shall be established, based on sound commercial practice.

(ii) For plant equipment of the types covered in Federal Supply classes 3405, 3408, 3410, and 3411 through 3419, machine tools; and in 3441 through 3449, secondary metal forming and cutting machines, the following monthly rates shall apply:

Age of Equipment	Monthly Rental Rate
Under 2 years old	3.0 percent
Over 2 to 3 years old	2.0 percent
Over 3 to 6 years old	1.5 percent
Over 6 to 10 years old	1.0 percent
Over 10 years old	0.75 percent

The age of each item of the equipment shall be based on the year in which it was manufactured, with a birthday on January 1 of each year thereafter. For example, an item of equipment manufactured on July 15, 1978, will be considered to be "over 1 year old" on and after January 1, 1979, and "over 2 years old" on and after January 1, 1980.

(iii) For personal property and equipment not covered in (i) or (ii) above, a rental shall be established at not less than the prevailing commercial rate, if any, or, in the absence of such rate, not less than 2 percent per month for electronic test equipment and automotive equipment and not less than 1 percent per month for all other property and equipment.

(End of clause)

(R 7-702.12 1976 OCT)

52.245-10 Government Property (Facilities Acquisition).

As prescribed in 45.302-6(d), insert the following clause in solicitations and contracts when a facilities acquisition contract is contemplated:

GOVERNMENT PROPERTY (FACILITIES ACQUISITION) (APR 1984)

(a) *Definitions.*

"Facilities," as used in this clause, means all property provided under this facilities contract.

"Related contract," as used in this clause, means a Government contract or subcontract for supplies or services under which the use of the facilities is or may be authorized.

(b) *Facilities to be provided.* (1) The Contractor, at Government expense and subject to the provisions of this contract, shall acquire, construct, or install the facilities and perform the related work as described in the Schedule.

(2) The Government, subject to the provisions of this contract, shall furnish to the Contractor the facilities identified in the Schedule as Government-furnished facilities. The Contractor, at Government expense, shall perform the work with respect to those Government-furnished facilities as is described in the Schedule.

(c) *Title in the facilities.* (1) The Government shall retain title to all Government-furnished property.

(2) Title to all facilities and components shall pass to and vest in the Government upon delivery by the vendor of all such items purchased by the Contractor for which it is entitled to be reimbursed as a direct item of cost under this contract.

(3) Title to other property, the cost of which is reimbursable to the Contractor under this contract, shall pass to and vest in the Government upon—

(i) Issuance of the property for use in performing this contract;

(ii) Commencement of processing or use of the property in performing this contract; or

(iii) Reimbursement of the cost of the property by the Government, whichever occurs first.

(4) Title to the facilities shall not be affected by their incorporation into, or attachment to, any property not owned by the Government, nor shall any item of the facilities become a fixture or lose its identity as personal property by being attached to any real property. The Contractor shall keep the facilities free and clear of all liens and encumbrances and, except as otherwise authorized by this contract or by the Contracting Officer, shall not remove or otherwise part with possession of, or permit the use by others of, any of the facilities.

(5) The Contractor may, with the written approval of the Contracting Officer, install, arrange, or rearrange, on Government-furnished premises, readily movable machinery, equipment, and other items belonging to the Contractor. Title to any such item shall remain in the Contractor even though it may be attached to real property owned by the Government, unless the Contracting Officer determines that it is so permanently attached that removal would cause substantial injury to Government property.

(6) The Contractor shall not construct or install, at its own expense, any fixed improvement or structural alterations in Government buildings or other real property without advance written approval of the Contracting Officer. Fixed improvement, or structural alterations, as used herein, means any alteration or improvement in the nature of the building or other real property, that, after completion, cannot be removed without substantial loss of value or damage to the premises. The term does not include foundations for production equipment.

(d) *Property control.* The Contractor shall maintain property control procedures and records and a system of identification of the facilities in accordance with the provisions of Federal Acquisition Regulation (FAR) Subpart 45.5 in effect on the date of this contract. The provisions of FAR 45.5 are hereby incorporated by reference and made a part of this contract.

(e) *Access.* The Government and any persons designated by it shall, at all reasonable times, have access to the premises where any of the facilities are located.

(f) *Indemnification of the Government.* The Contractor shall indemnify the Government and hold it harmless against claims for injury to persons or damage to property of the Contractor or others arising from the Contractor's possession or use of the facilities, except as specified in the clause at FAR 52.228-6, Insurance—Liability to Third Persons, or at FAR 52.228-7, Liability to Third Persons—Total Immunity. However, the provisions of the Contractor's related contracts shall govern any assumption of liability by the Government for claims arising under such related contracts.

(g) *Late delivery, diversion, and substitution.* (1) The Government shall not be liable for breach of contract for any delay in delivery or nondelivery of facilities to be furnished under this contract.

(2) The Government has the right, at its expense, to divert the facilities under this contract by directing the Contractor to—

(i) Deliver any of the facilities to locations other than those specified in the Schedule; or

(ii) Assign purchase orders or subcontracts for any of the facilities to the Government or third parties.

(3) The Government may furnish any facilities instead of having the Contractor acquire or construct them. In such event, the Contractor is entitled to reimbursement for the cost related to the acquisition or construction of the facilities, including the cost of terminating purchase orders and subcontracts.

(4) Appropriate equitable adjustment may be made in any related contract that so provides and that is affected by nondelivery, delay, diversion, or substitution under this paragraph (g).

(h) *Representations and warranties.* (1) The Government makes no warranty, express or implied, regarding the condition or fitness for use of any facilities. To the extent practical, the Contractor shall be allowed to inspect all the facilities to be furnished by the Government before their shipment.

(2) If the Contractor receives facilities in a condition not suitable for the intended use, the Contractor shall, within 30 days after receipt and installation thereof, so notify the Contracting Officer, detailing the facts, and, as directed by the Contracting Officer and at Government expense, either (i) return such item or otherwise dispose of it or (ii) effect repairs or modifications. An appropriate equitable adjustment may be made in any related contract that so provides and that is affected by the return, disposition, repair or modification of any facilities.

(i) *Supersedure.* Upon the acquisition, construction, or installation of the facilities called for by this contract, or any usable increment of the facilities, and acceptance by the Government, the facilities shall then be subject to the provisions of the facilities contract that authorizes the use of the items.

(End of clause)
(R 7-702.1 1964 SEP)
(AV 7-702.2 1964 SEP)
(R 7-702.15 1964 SEP)
(R 7-705.7 1964 SEP)
(R 7-702.17 1969 APR)
(AV 7-702.16 1964 SEP)
(R 7-702.20 1964 SEP)
(R 7-702.3 1964 SEP)
(R 7-702.5 1964 SEP)
(AV 7-703.39 1964 SEP)

52.245-11 Government Property (Facilities Use).

As prescribed in 45.302-6(e)(1), insert the following clause:

GOVERNMENT PROPERTY (FACILITIES USE) (APR 1984)

(a) *Definitions.* "Facilities," as used in this clause, means property provided under this facilities contract.

"Related contract," as used in this clause, means a Government contract or subcontract for supplies or services under which the use of the facilities is or may be authorized.

(b) *Period of this contract.* If not otherwise specified in this contract and if not previously terminated under paragraph (k), the use of the facilities authorized under this contract shall terminate 5 years after its effective date. Thereafter, if continued use of the facilities by the Contractor is mutually desired, the parties shall enter into a new contract that shall incorporate such provisions as may then be required by applicable laws and regulations. The parties may, by written agreement, extend the use of the facilities under this contract beyond this 5-year period to permit the completion of any then-existing related contracts and subcontracts.

(c) *Title in the facilities.* (1) Title to the facilities shall remain in the Government. Title to parts replaced by the Contractor in carrying out its normal maintenance obligations under paragraph (g) shall pass to and vest in the Government upon completion of their installation in the facilities.

(2) Title to the facilities shall not be affected by their incorporation into or attachment to any property not owned by the Government, nor shall any item of the facilities become a fixture or lose its identity as personal property by being attached to any real property. The Contractor shall keep the facilities free and clear of all liens and encumbrances and, except as otherwise authorized by this contract or by the Contracting Officer, shall not remove or otherwise part with possession of, or permit the use by others of, any of the facilities.

(3) The Contractor may, with the written approval of the Contracting Officer, install, arrange, or rearrange, on Government-furnished premises, readily movable machinery, equipment, and other items belonging to the Contractor. Title to any such item shall remain in the Contractor even though it may be attached to real property owned by the Government, unless the Contracting Officer determines that it is so permanently attached that removal would cause substantial injury to Government property.

(4) The Contractor shall not construct or install, at its own expense, any fixed improvement or structural alterations in Government buildings or other real property without advance written approval of the Contracting Officer. Fixed improvement or structural alterations, as used herein, means any alteration or improvement in the nature of the building or other real property that, after completion, cannot be removed without substantial loss of value or damage to the premises. The term does not include foundations for production equipment.

(d) *Location of the facilities.* The Contractor may use the facilities at any of the locations specified in the Schedule and, with the prior written approval of the Contracting Officer, at any other location. In granting this approval, the Contracting Officer may prescribe

such terms and conditions as may be deemed necessary for protecting the Government's interest in the facilities involved. Those terms and conditions shall take precedence over any conflicting provisions of this contract.

(e) *Notice of use of the facilities.* The Contractor shall notify the Contracting Officer in writing—

(1) Whenever use of all facilities for Government work in any quarterly period averages less than 75 percent of the total use of the facilities; or

(2) Whenever any item of the facilities is no longer needed or usable for performing existing related contracts that authorize such use.

(f) *Property control.* The Contractor shall maintain property control procedures and records, and a system of identification of the facilities, in accordance with the provisions of Federal Acquisition Regulation (FAR) Subpart 45.5 in effect on the date of this contract. The provisions of FAR 45.5 are hereby incorporated by reference and made a part of this contract.

(g) *Maintenance.* (1) Except as otherwise provided in the Schedule, the Contractor shall protect, preserve, maintain (including normal parts replacement), and repair the facilities in accordance with sound industrial practice.

(2) As soon as practicable after the execution of this contract, the Contractor shall submit to the Contracting Officer a written proposed maintenance program, including a maintenance records system, in sufficient detail to show the adequacy of the proposed program. If the Contracting Officer agrees to the proposed program, it shall become the normal maintenance obligation of the Contractor. The Contractor's performance according to the approved program shall satisfy the Contractor's obligations under subparagraphs (g)(1) and (g)(5) of this clause.

(3) The Contracting Officer may at any time direct the Contractor in writing to reduce the work required by the normal maintenance program. If such order reduces the cost of performing the maintenance, an appropriate equitable adjustment may be made in any affected related contract that so provides.

(4) The Contractor shall perform any maintenance work directed by the Contracting Officer in writing. Work in excess of the maintenance required under subparagraphs (g)(1) through (g)(3) of this clause shall be at Government expense. The Contractor shall notify the Contracting Officer in writing when sound industrial practice requires maintenance in excess of the normal maintenance program.

(5) The Contractor shall keep records of all work done on the facilities and shall give the Government reasonable opportunity to inspect such records. When facilities are disposed of under this contract, the Contractor shall deliver the related records to the Government or, if directed by the Contracting Officer, to third persons.

(6) The Contractor's obligation under this clause for each item of facilities shall continue until the item is removed, abandoned, or disposed of at the expiration of the 120-day period stated in subparagraph (l)(4) of this clause and when the Contractor has discharged its other obligations under this contract with respect to such items.

(h) *Access.* The Government and any persons designated by it shall, at all reasonable times, have access to the premises where any of the facilities are located.

(i) *Indemnification of the Government.* The Contractor shall indemnify the Government and hold it harmless against claims for injury to persons or damage to property of the Contractor or others arising from the Contractor's possession or use of the facilities under this contract. However, the provisions of the Contractor's related contracts shall govern any assumption of liability by the Government for claims arising under those contracts.

(j) *Representations and warranties.* (1) The Government makes no warranty, express or implied, regarding the condition or fitness for use of any facilities. To the extent practical, the Contractor shall be allowed to inspect all the facilities to be furnished by the Government before their shipment.

(2) If the Contractor receives facilities in a condition not suitable for the intended use, the Contractor shall, within 30 days after receipt and installation thereof, so notify the Contracting Officer, detailing the facts, and, as directed by the Contracting Officer and at Government expense, either (i) return such item or otherwise dispose of it or (ii) effect repairs or modifications. An appropriate equitable adjustment may be made in any related contract that so provides and that is affected by the return, disposition, repair, or modification of any facilities.

(k) *Termination of use of the facilities.* (1) The Contractor may at any time, upon written notice to the Contracting Officer, terminate its authority to use any or all of the facilities. Termination under this paragraph (k) shall not relieve the Contractor of any of its obligations or liabilities under any related contract or subcontract affected by the termination.

(2) The Contracting Officer may at any time, upon written notice, terminate or limit the Contractor's authority to use any of the facilities. Except as otherwise provided in the Failure to Perform clause of this contract, an equitable adjustment may be made in any related contract of the Contractor that so provides and that is affected by such notice.

(l) *Disposition of the facilities.* (1) The provisions of this paragraph (l) shall apply to facilities whose use has been terminated by either the Contracting Officer or the Contractor under paragraph (k), except as provided in subparagraph (l)(2).

(2) Unless otherwise directed by the Contracting Officer, this paragraph (l) shall not apply to facilities terminated by the Contractor if—

(i) The facilities terminated do not comprise all of the facilities in the possession of the Contractor; and

(ii) The Contracting Officer determines that continued retention of the facilities will not interfere with the Contractor's operations.

(3) Within 60 days after the effective date of any notice of termination given under paragraph (k) or within such longer period as the Contracting Officer may approve in writing, the Contractor shall submit to the Contracting Officer an accounting for all the facilities covered by such notice. The submission of the Contractor shall be in a form satisfactory to the Contracting Officer.

(4) Within 120 days after the Contractor accounts for any facilities under subparagraph (l)(3), the Contracting Officer shall give written notice to the Contractor as to the disposition of the facilities, except as otherwise provided in subparagraph (l)(6). In its disposition of the facilities, the Government may either—

(i) Abandon the facilities in place, in which case all obligations of the Government regarding such abandoned facilities and the rehabilitation of the premises in and on which they are located shall immediately cease; or

(ii) Require the Contractor to comply, at Government expense, with such directions as the Contracting Officer may give with respect to—

(A) The preparation, protection, removal, or shipment of the affected facilities;

(B) The retention or storage of the affected facilities; *provided*, that the Contracting Officer shall not direct the Contractor to retain or store any items of facilities in or on real property not owned by the Government if such retention or storage will interfere with the Contractor's operations;

(C) The restoration of Government-owned property incident to the removal of the facilities from such property; and

(D) The sale of any affected facilities in such manner, at such times, and at such price as may be approved by the Government, except that the Contractor shall not be required to extend credit to any purchaser.

(5) If the Contracting Officer fails to give the written notice required by subparagraph (l)(4) of this clause within the prescribed 120-day period, the Contractor may, upon not less than 30 days' written notice to the Government, and at Government risk and expense, (i) retain the facilities in place or (ii) remove any of the affected severable facilities located in Contractor-owned property and store them at the Contractor's plant or in a public insured warehouse. Such removal and storage shall be in accordance with sound practice and in a manner compatible with the security classification of the facilities. Except as provided in this subparagraph (l)(5), the Government shall not be liable to the Contractor for failure to give the written notice required by subparagraph (l)(4).

(6) Nonseverable items of the facilities or items of the facilities subject to patent or proprietary rights shall be disposed of in such manner as the parties may have agreed to in writing.

(7) The Government, either directly or by third persons engaged by it, may remove or otherwise dispose of any facilities for which the Contractor's authority to use has been terminated, other than those for which specific provision is made in subparagraph (l)(6).

(8) The Contractor shall, within a reasonable time after the expiration of the 120-day period specified in subparagraph (l)(4), remove all of its property from the Government property and take such action as the Contracting Officer may direct in writing with respect to restoring such Government property, to the extent that it is affected by the installation of the Contractor's property, to its condition before such installation.

(9) Unless otherwise specifically provided in this contract, the Government shall not be obligated to the Contractor to restore or rehabilitate any property at the Contractor's plant, except for restoration or rehabilitation costs caused by removal of the facilities under subdivision (l)(4)(ii). The Contractor agrees to indemnify the Government against all suits or claims for damages arising out of the Government's failure to restore or rehabilitate any property at the Contractor's plant or property of its subcontractors, except any damage as may be caused by the negligence of the Government, its agents, or independent contractors.

(m) *Supersedure.* (1) Facilities previously provided to the Contractor under the contracts specified in the Schedule of this contract shall become subject to this contract upon its effective date. The terms of those contracts by which such facilities were previously provided to the Contractor are hereby superseded with respect to such facilities, except for rights and obligations that may have accrued under such other contract before the effective date of this contract.

(2) Facilities subsequently provided the Contractor under any contract shall, if that contract so specifies, be subject to this contract upon the completion of their construction, acquisition, and installation or upon their availability for use, whichever occurs first, except as otherwise provided in the contract or other document by which such facilities are provided to the Contractor.

(End of clause)

(R 7-702.1 1964 SEP)
(R 7-702.25 1964 SEP)
(R 7-702.15 1964 SEP)
(R 7-705.7 1964 SEP)
(R 7-702.23 1968 SEP)
(R 7-702.17 1969 APR)
(R 7-702.14 1964 SEP)
(AV 7-702.16 1964 SEP)
(R 7-702.20 1964 SEP)
(R 7-704.15 1964 SEP)
(R 7-702.3 1964 SEP)
(R 7-702.5 1964 SEP)
(R 7-706.7 1968 SEP)
(R 7-706.15 1968 SEP)
(AV 7-702.24 1964 SEP)
(R 7-702.26 1968 APR)
(R 7-704.31 1964 SEP)

Alternate I (JUL 1985). As prescribed in 45.302-6(e)(2), substitute the following paragraph (c) for paragraph (c) of the basic clause:

(c) *Title.* (1) Title to equipment (and other tangible personal property) having a unit acquisition cost of less than $5,000, purchased with funds available for research, shall vest in the Contractor upon acquisition or as soon thereafter as feasible, provided that the Contractor received the Contracting Officer's approval before acquiring the equipment. Title to other equipment purchased with Government funds shall vest in the Government. The Government may at any time during the term of this contract or upon its completion or termination transfer to the Contractor the title to any equipment purchased with funds available for research. Any such transfer shall be upon terms and conditions agreed to by the parties. The Contractor agrees that it shall not charge under any Government contract or subcontract any depreciation, amortization, or use of the equipment purchased or transferred under this paragraph. When title to equipment is vested in the Contractor or is transferred under this paragraph to the Contractor, the equipment ceases to be Government property. Within 10 days after the end of the calendar quarter in which such acquisition or transfer of title occurs, the Contractor shall furnish the Contracting Officer a list of all equipment, title to which is vested in the Contractor.

(2) (i) The Government shall retain title to all Government-furnished property.

(ii) Except as set forth in subparagraph (c)(1), title to all property shall pass to and vest in the Government upon delivery by the vendor of all such items purchased by the Contractor for which it is entitled to be reimbursed as a direct item of cost under this or a related contract.

(iii) Title to replacement parts furnished by the Contractor in performing its normal obligations under paragraph (g) shall pass to and vest in the Government upon completion of their installation in the facilities.

(iv) Title to other property, the cost of which is reimbursable to the contractor under this contract or a related contract, shall pass to and vest in the Government upon—

(A) Issuance of the property for use in performing this contract;

(B) Commencement of processing or use of the property in performing this contract; or

(C) Reimbursement of the cost of the property by the Government, whichever occurs first.

(3) Title to the facilities shall not be affected by their incorporation into or attachment to any property not owned by the Government, nor shall any item of the facilities become a fixture or lose its identity as personal property by being attached to any real property. The Contractor shall keep the facilities free and clear of all liens and encumbrances and, except as otherwise authorized by this contract or by the Contracting Officer, shall not remove or otherwise part with possession of, or permit the use by others of, any of the facilities.

(4) The Contractor may, with the written approval of the Contracting Officer, install, arrange, or rearrange, on Government-furnished premises, readily movable machinery, equipment, and other items belonging to the Contractor. Title to any such item shall remain in the Contractor even though it may be attached to real property owned by the Government, unless the Contracting Officer determines that it is so permanently attached that removal would cause substantial injury to Government property.

(5) The Contractor shall not construct or install, at its own expense, any fixed improvement or structural alterations in Government buildings or other real property without advance written approval of the Contracting Officer. Fixed improvement, as used herein, means any alteration or improvement in the nature of the building or other real property that, after completion, cannot be removed without substantial loss of value or damage to the premises. The term does not include foundations for production equipment.

(6) Vesting title under this paragraph (c) is subject to civil rights legislation, 42 U.S.C. 2000d. Before title is vested and by signing this contract, the Contractor accepts and agrees that—

"No person in the United States shall, on the ground of race, color, or national origin, be excluded from participation in, be denied the benefits of, or be otherwise subjected to discrimination under this contemplated financial assistance (title to equipment)."

52.245-12 Contract Purpose (Nonprofit Educational Institutions).

As prescribed in 45.302-7(a), the contracting officer may insert the following clause in solicitations and con-

tracts when a facilities use contract is contemplated and award may be made to a nonprofit educational institution:

CONTRACT PURPOSE (NONPROFIT EDUCATIONAL INSTITUTIONS) (APR 1984)

This facilities use contract is designed specifically for nonprofit educational institutions to set forth provisions for the use and accountability of facilities furnished or acquired under related contracts identified elsewhere herein. There are no funds provided under this contract. Costs incurred for acquisition, maintenance, repair, replacement, disposition, or other purposes in connection with the facilities accountable hereunder will be subject to the reimbursement provisions of the related contracts; *provided*, however, that should no other contract be available for reimbursement of such costs, this contract may be appropriately modified to provide for such reimbursement.

(End of clause)

(AV 7-706.1 1968 SEP)

52.245-13 Accountable Facilities (Nonprofit Educational Institutions).

As prescribed in 45.302-7(b), the contracting officer may insert the following clause in solicitations and contracts when a facilities contract is contemplated and award may be made to a nonprofit educational institution:

ACCOUNTABLE FACILITIES (NONPROFIT EDUCATIONAL INSTITUTIONS) (APR 1984)

The facilities accountable under this contract are those facilities furnished or acquired under this contract and those facilities furnished or acquired under those related contracts that are specifically identified in this contract Schedule.

(End of clause)

(R 7-706.2 1968 SEP)

52.245-14 Use of Government Facilities.

As prescribed in 45.302-7(c), the contracting officer may insert the following clause in solicitations and contracts when a facilities use contract is contemplated and award may be made to a nonprofit educational institution:

USE OF GOVERNMENT FACILITIES (APR 1984)

The Contractor may use the facilities without charge in performing—

(a) Contracts with the Government which specifically authorize such use without charge;

(b) Subcontracts of any tier if the Contracting Officer having cognizance of the prime contract has authorized, in writing, use without charge; and

(c) Other work for which the Contracting Officer has specifically authorized use without charge in writing.

(End of clause)

(R 7-706.4 1968 SEP)

52.245-15 Transfer of Title to the Facilities.

As prescribed in 45.302-7(d), insert the following clause:

TRANSFER OF TITLE TO THE FACILITIES (JUL 1985)

(a) The Contracting Officer may, at any time during the term of this contract and acting under Public Law 97-258 (31 U.S.C. 6306), transfer title to equipment to the Contractor upon mutually agreeable terms and conditions. This clause takes precedence over the title paragraph of the Government property clause of this contract. However, every agreement to transfer title to equipment shall provide that the Contractor will not include in the contract price or charge the Government in any manner for depreciation, amortization, or use of such equipment.

(b) Vesting title under paragraph (a) above is subject to civil rights legislation, 42 U.S.C. 2000d. Before title is vested and by signing this contract, the contractor accepts and agrees that—

"No person in the United States shall, on the ground of race, color, or national origin, be excluded from participation in, be denied the benefits of, or be otherwise subjected to discrimination under this contemplated financial assistance (title to equipment)."

(End of clause)

52.245-16 Facilities Equipment Modernization.

As prescribed in 45.302-7(e), insert the following clause:

FACILITIES EQUIPMENT MODERNIZATION (APR 1985)

(a) The Contractor agrees to return to the Government the net cost savings realized from using modernized or replacement equipment provided by the Government under this contract. This applies to using such equipment on any contracts or subcontracts that are firm-fixed price, or that are fixed-price with economic price adjustment provisions, entered into within the 3 years following the date such equipment is placed into production. This provision does not apply to the use of such equipment in sealed bid contracts entered into after the equipment is placed in production or in contracts or subcontracts that specifically provide that they have been priced on the basis of anticipated use of such equipment.

(b) (1) The Contractor shall maintain adequate records for implementing this clause. The Contractor shall make such records available at its office for inspection, audit, or reproduction by any authorized representative of the Contracting Officer.

(2) When the Contractor authorizes a subcontractor to use the modernized or replacement equipment, the subcontractor shall be required to maintain records and make them and additional information available to the Contracting Officer.

(c) Records of equipment shall generally be acceptable if they are maintained under established accounting practices and permit a fair estimation of the net cost savings realized. Net cost savings realized shall be determined by a comparison of the Contractor's cost experience in the operation of the equipment before and after modernization.

(d) Amounts due the Government under this clause shall be returned by the Contractor, as directed by the Contracting Officer, by—

(1) Credits to, or adjustment of the prices of, the related contracts benefitting from using the modernized or replacement equipment;

(2) Payment to the Government through the Contracting Officer having cognizance of the equipment; or

(3) Any other means mutually agreed to.

(End of clause)

52.245-17 Special Tooling.

As prescribed in 45.305(a)(1), when contracting by negotiation, insert the following clause in solicitations and contracts when a fixed-price contract is contemplated, the contracting officer decides to acquire rights to the contractor's special tooling, and it is not practical to identify the special tooling required:

SPECIAL TOOLING (APR 1984)

(a) *Definition.* "Special tooling" means jigs, dies, fixtures, molds, patterns, taps, gauges, other equipment and manufacturing aids, all components of these items, and replacement of these items, that are of such a specialized nature that without substantial modification or alteration their use is limited to the development or production of particular supplies or parts thereof or performing particular services. It does not include material, special test equipment, facilities (except foundations and similar improvements necessary for installating special tooling), general or special machine tools, or similar capital items. Special tooling, for the purpose of this clause, does not include any item acquired by the Contractor before the effective date of this contract, or replacement of such items, whether or not altered or adapted for use in performing this contract, or items specifically excluded by the Schedule of this contract.

(b) *Use of special tooling.* The Contractor agrees to use the special tooling only in performing this contract or as otherwise approved by the Contracting Officer.

(c) *Initial list of special tooling.* If the Contracting Officer so requests, the Contractor shall furnish the Government an initial list of all special tooling acquired or manufactured by the Contractor for performing this contract (but see paragraph (d) for tooling that has become obsolete). The list shall specify the nomenclature, tool number, related product part number (or service performed), and unit or group cost of the special tooling. The list shall be furnished within 60 days after delivery of the first production end item under this contract unless a later date is prescribed.

(d) *Changes in design.* Changes in the design or specifications of the end items being produced under this contract may affect the interchangeability of end item parts. In such an event, unless otherwise agreed to by the Contracting Officer, the Contractor shall notify the Contracting Officer of any part not interchangeable with a new or superseding part. Pending disposition instructions, such usable tooling shall be retained and maintained by the Contractor.

(e) *Contractor's offer to retain special tooling.* The Contractor may indicate a desire to retain certain items of special tooling at the time it furnishes a list or notification pursuant to paragraphs (c), (d), or (h) of this clause. The Contractor shall furnish a written offer designating those items that it wishes to retain by specifically listing the items or by listing the particular products, parts, or services for which the items were used or designed. The offer shall be made on one of the following bases:

(1) An amount shall be offered for retention of the items free of any Government interest. This amount should ordinarily not be less than the current fair value of the items, considering, among other things, the value of the items to the Contractor for use in future work.

(2) Retention may be requested for a limited period of time and under terms as may be agreed to by the Government and the Contractor. This temporary retention is subject to final disposition pursuant to paragraph (i) of this clause.

(f) *Property control records.* The Contractor shall maintain adequate property control records of all special tooling in accordance with its normal industrial practice. The records shall be made available for Government inspection at all reasonable times. To the extent practicable, the Contractor shall identify all special tooling subject to this clause with an appropriate stamp, tag, or other mark.

(g) *Maintenance.* The Contractor shall take all reasonable steps necessary to maintain the identity and existing condition of usable items of special tooling from the date such items are no longer needed by the Contractor until final disposition under paragraph (i) of

this clause. These maintenance requirements do not apply to those items designated by the Contracting Officer for disposal as scrap or identified as of no further interest to the Government under subparagraph (i)(4) of this clause. The Contractor is not required to keep unneeded items of special tooling in place.

(h) *Final list of special tooling.* When all or a substantial part of the work under this contract is completed or terminated, the Contractor shall furnish the Contracting Officer a final list of special tooling with the same information as required for the initial list under paragraph (c) of this clause. The final list shall include all items not previously reported under paragraph (c). The Contracting Officer may provide a written waiver of this requirement or grant an extension. The requirement may be extended until the completion of this contract together with the completion of other contracts and subcontracts authorizing the use of the special tooling under paragraph (b) of this clause. Special tooling that has become obsolete as a result of changes in design or specification need not be reported except as provided for in paragraph (d).

(i) *Disposition instructions.* The Contracting Officer shall provide the Contractor with disposition instructions for special tooling identified in a list or notice submitted under paragraphs (c), (d), or (h) of this clause. The instructions shall be provided within 90 days of receipt of the list or notice, unless the period is extended by mutual agreement. The Contracting Officer may direct disposition by any of the methods listed in subparagraphs (1) through (4) of this paragraph, or a combination of such methods. Any failure of the Contracting Officer to provide specific instructions within the 90-day period shall be construed as direction under subparagraph (i)(3).

(1) The Contracting Officer shall give the Contractor a list specifying the products, parts, or services for which the Government may require special tooling and request the Contractor to transfer title (to the extent not previously transferred under any other clause of this contract) and deliver to the Government all usable items of special tooling that were designed for or used in the production or performance of such products, parts, or services and that were on hand when such production or performance ceased.

(2) The Contracting Officer may accept or reject any offer made by the Contractor under paragraph (e) of this clause to retain items of special tooling or may request further negotiation of the offer. The Contractor agrees to enter into the negotiations in good faith. The net proceeds from the Contracting Officer's acceptance of the Contractor's retention offer shall either be deducted from amounts due the Contractor under this contract or shall be otherwise paid to the Government as directed by the Contracting Officer.

(3) The Contracting Officer may direct the Contractor to sell, or dispose of as scrap, for the account of the Government, any special tooling reported by the Contractor under this clause. The net proceeds of all sales shall either be deducted from amounts due the Contractor under this contract or shall be otherwise paid to the Government as directed by the Contracting Officer. To the extent that the Contractor incurs any costs occasioned by compliance with such directions, for which it is not otherwise compensated, the contract price shall be equitably adjusted in accordance with the Changes clause of this contract.

(4) The Contracting Officer may furnish the Contractor with a statement disclaiming further Government interest or rights in any of the special tooling listed.

(j) *Storage or shipment.* The Contractor shall promptly transfer to the Government title to the special tooling specified by the Contracting Officer and arrange for either the shipment or the storage of such tooling in accordance with the final disposition instructions in subparagraph (i)(1) of this clause. Tooling to be shipped shall be properly packaged, packed, and marked in accordance with the directions of the Contracting Officer. Tooling to be stored shall be stored pursuant to a storage agreement between the Government and the Contractor, and as directed by the Contracting Officer. Tooling shipped or stored shall be accompanied by operation sheets or other appropriate data necessary to show the manufacturing operations or processes for which the items were used or designed. To the extent that the Contractor incurs costs for authorized storage or shipment under this paragraph and not otherwise compensated for, the contract price shall be equitably adjusted in accordance with the Changes clause of this contract.

(k) *Subcontract provisions.* In order to perform this contract, the Contractor may place subcontracts (including purchase orders) involving the use of special tooling. If the full cost of the tooling is charged to those subcontracts, the Contractor agrees to include in the subcontracts appropriate provisions to obtain Government rights comparable to the rights of the Government under this clause (unless the Contractor and the Contracting Officer agree that such rights are not of substantial interest to the Government). The Contractor agrees to exercise such rights for the benefit of the Government as directed by the Contracting Officer.

(End of clause)

(R 7-104.25 1967 OCT)

Alternate I (APR 1984). If the Government does not intend to acquire special tooling from subcontractors and an appropriate price reduction is obtained, delete paragraph (k) from the basic clause.

(R 13-305.2(c) 1976 JUL)

52.245-18 Special Test Equipment.

As prescribed in 45.305(b), insert the following clause in solicitations and contracts when contracting by negotiation and the contractor will acquire or fabricate special test equipment for the Government but the exact identification of the special test equipment to be acquired or fabricated is unknown:

SPECIAL TEST EQUIPMENT (APR 1984)

(a) "Special test equipment," as used in this clause, means either single or multipurpose integrated test units engineered, designed, fabricated, or modified to accomplish special purpose testing in performing a contract. These testing units comprise electrical, electronic, hydraulic, pneumatic, mechanical, or other items or assemblies of equipment that are mechanically, electrically, or electronically interconnected so as to become a new functional entity, causing the individual item or items to become interdependent and essential in performing special purpose testing in the development or production of peculiar supplies or services. It does not include material, special tooling, facilities (except foundations and similar improvements necessary for installing special test equipment), and plant equipment items used for general plant testing purposes.

(b) The Contractor may either acquire or fabricate special test equipment at Government expense when the equipment is not otherwise itemized in this contract and the prior approval of the Contracting Officer has been obtained. The Contractor shall provide the Contracting Officer with a written notice, at least 30 days in advance, of the Contractor's intention to acquire or fabricate the special test equipment. As a minimum, the notice shall also include an estimated aggregate cost of all items and components of the equipment the individual cost of which is less than $1,000, and the following information on each item or component of equipment costing $1,000 or more:

(1) The end use application and function of each proposed special test unit, identifying special characteristics and the reasons for the classification of the test unit as special test equipment.

(2) A complete description identifying the items to be acquired and the items to be fabricated by the Contractor.

(3) The estimated cost of the item of special test equipment or component.

(4) A statement that intra-plant screening of Contractor and Government-owned special test equipment and components has been accomplished and that none are available for use in performing this contract.

(c) The Government may furnish any special test equipment or components rather than approve their acquisition or fabrication by the Contractor. Such Government-furnished items shall be subject to the Government Property clause, except that the Government shall not be obligated to deliver such items any sooner than the Contractor could have acquired or fabricated them after expiration of the 30-day notice period in paragraph (b) of this clause. However, unless the Government notifies the Contractor of its decision to furnish the items within the 30-day notice period, the Contractor may proceed to acquire or fabricate the equipment or components subject to any other applicable provisions of this contract.

(d) The Contractor shall, in any subcontract that provides that special test equipment or components may be acquired or fabricated for the Government, insert provisions that conform substantially to the language of this clause, including this paragraph (d). The Contractor shall furnish the names of such subcontractors to the Contracting Officer.

(e) If an engineering change requires either the acquisition or fabrication of new special test equipment or substantial modification of existing special test equipment, the Contractor shall comply with paragraph (b) above. In so complying, the Contractor shall identify the change order which requires the proposed acquisition, fabrication, or modification.

(End of clause)

(R 7-104.26 1973 APR)

52.245-19 Government Property Furnished "As Is."

As prescribed in 45.305(c), insert the following clause in solicitations and contracts when a contract other than a consolidated facilities contract, a facilities acquisition contract, or a facilities use contract is contemplated and Government production and research property is to be furnished "as is." (See 45.106 for additional clauses that may be required):

GOVERNMENT PROPERTY FURNISHED "AS IS" (APR 1984)

(a) The Government makes no warranty whatsoever with respect to Government property furnished "as is," except that the property is in the same condition when placed at the f.o.b. point specified in the solicitation as when inspected by the Contractor pursuant to the solicitation or, if not inspected by the Contractor, as when last available for inspection under the solicitation.

(b) The Contractor may repair any property made available on an "as is" basis. Such repair will be at the Contractor's expense except as otherwise provided in this clause. Such property may be modified at the Contractor's expense, but only with the written permission of the Contracting Officer. Any repair or modification of property furnished "as is" shall not affect the title of the Government.

(c) If there is any change in the condition of Government property furnished "as is" from the time inspected or last available for inspection under the solicitation to the time placed on board at the location specified in the solicitation, and such change will adversely affect the Contractor, the Contractor shall, upon receipt of the property, notify the Contracting Officer detailing the facts and, as directed by the Contracting Officer, either (1) return such property at the

Government's expense or otherwise dispose of the property or (2) effect repairs to return the property to its condition when inspected under the solicitation or, if not inspected, last available for inspection under the solicitation. After completing the directed action and upon written request of the Contractor, the Contracting Officer shall equitably adjust any contractual provisions affected by the return, disposition, or repair in accordance with the procedures provided for in the Changes clause of this contract. The foregoing provisions for adjustment are the exclusive remedy available to the Contractor, and the Government shall not be otherwise liable for any delivery of Government property furnished "as is" in a condition other than that in which it was originally offered.

(d) Except as otherwise provided in this clause, Government property furnished "as is" shall be governed by the Government Property clause of this contract.

(End of clause)

(AV 7-104.24(e) 1965 APR)

PART 45--GOVERNMENT PROPERTY
SUBPART 45.3--PROVIDING GOVERNMENT PROPERTY TO CONTRACTORS

45.301 Definitions.

"Agency-peculiar property," as used in DoD, means military property and includes end items and integral components of military weapons systems, along with the related peculiar support equipment which is not readily available as a commercial item.

"Facilities Project" means an undertaking by the Government to provide facilities to a contractor for the performance of a Government contract or subcontract or to modernize or replace facilities for the same purpose.

"Industrial Plant Equipment" (IPE) is that part of plant equipment with an acquisition cost of $5,000 or more; used for the purpose of cutting, abrading, grinding, shaping, forming, joining, testing, measuring, heating, treating, or otherwise altering the physical, electrical or chemical properties of materials, components or end items entailed in manufacturing, maintenance, supply, processing, assembly, or research and development operations; and IPE is further identified by noun name in the following Joint DoD Handbooks:

INDEX OF INDUSTRIAL PLANT EQUIPMENT HANDBOOKS
(NOTE--Handbooks are for sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402)

FSC	TITLE	ARMY	NAVY	AIR FORCE	DLA	MARINE CORPS
3424, 4430	Industrial Furnaces & Ovens Volume 1 and 2	SB 708-4430-1	NAVSUP Pub 5502	AFM 78-8	DLAH 4215.4	MCO P4870.8B
6635	Physical Properties Testing Equipment	SB 708-6635-1	NAVSUP Pub 5504	AFM 78-10	DLAH 4215.6	MCO P4870.10C
6636	Environmental Chambers	SB 708-6636-1	NAVSUP Pub 5508	AFM 78-14	DLAH 4215.10	MCO P4870-14C
3422, 3426	Rolling Mills, Drawing Machines & Metal Finishing Equipment	SB 708-3400-2	NAVSUP Pub 5510	AFM 78-15	DLAH 4215.12	MCO P4870.16C
3450, 3460	Portable Machine Tools & Metal-working Machinery Accessories	SB 708-3400-3	NAVSUP Pub 5511	AFM 78-16	DLAH 4215.13	MCO P4870.17B
6650, 6670	Scales, Balances & Optical Instruments	SB 708-6600-2	NAVSUP Pub 5516	AFM 78-25	DLAH 4215.18	MCO P4870.22B
3680	Foundry Equipment	SB 708-3680-1	NAVSUP Pub 5517	AFM 78-23	DLAH 4215.19	MCO P4870.23A
6630, 6640	Chemical Analysis & Laboratory Instruments	SB 708-6600-3	NAVSUP Pub 5529	AFM 78-38	DLAH 4215.30	MCO P4870.35B
3620	Rubber and Plastics Working Machinery	SB 708-3620-1	NAVSUP Pub 5534	AFM 78-28	DLAH 4215.35	MCO P4870.40B
3611, 3693, 3695	Marking, Assembly, and Miscellaneous Industry Machinery	SB 708-3600-2	NAVSUP Pub 5535	AFM 78-26	DLAH 4215.36	MCO P4870.41B
3650	Chemical & Pharmaceutical Products Manufacturing Machinery	SB 708-3650-1	NAVSUP Pub 5536	AFM 78-45	DLAH 4215.37	MCO P4870.42A

FSC	TITLE	ARMY	NAVY	AIR FORCE	DLA	MARINE CORPS
4940	Miscellaneous Maintenance and Repair Shop Specialized Equipment	SB 708-4940-1	NAVSUP Pub 5537	AFM 78-48	DLAH 4215.38	MCO P4870.43A
3690, 4925	Specialized Ammunition and Ordnance Machinery	SB 708-4900-1	NAVSUP Pub 5538	AFM 78-49	DLAH 4215.39	MCO P4870.44A
3405	Metalworking Saws & Filing Machines	SB 708-3405-1	NAVSUP Pub 5539	AFM 78-34	DLAH 4215.40	MCO P4870.47B
3418	Planers and Shapers (Includes Shapers, formerly Part of FSC 3419)	SB 708-3418-1	NAVSUP Pub 5540	AFM 78-37	DLAH 4215.41	MCO P4870.48A
3431, 3432, 3433, 3436, 3438	Welding, Heat Cutting, and Metalizing Equipment	SB 708-3400-4	NAVSUP Pub 5541	AFM 78-39	DLAH 4215.42	MCO P4870.49A
3408, 3410	Machining Centers, Way Type Machines, Electrical and Ultrasonic Erosion Machines	SB 708-3400-5	NAVSUP Pub 5542	AFM 78-41	DLAH 4215.43	MCO P4870.50B
3419	Miscellaneous Machine Tools	SB 708-3400-6	NAVSUP Pub 5547	AFM 78-46	DLAH 4215.44	MCO P4870.51A
3413	Drilling And Tapping Machines	SB 708-3413-1	NAVSUP Pub 5548	AFM 78-50	DLAH 4215.45	MCO P4870.53B
3411, 3412, 3414	Boring Machines, Broaching Machines, Gear Cutting and Finishing Machines	SB 708-3400-7	NAVSUP Pub 5549	AFM 78-51	DLAH 4215.46	MCO P4870.55A
3441, 3442, 3443, 3445, 3446, 3447, 3448, 3449	Secondary Metal Forming and Cutting Machines	SB 708-3400-81	NAVSUP Pub 5551	AFM 78-53	DLAH 4215.48	MCO P4870.56A
3416	Metalworking Lathes	SB 708-3416-1	NAVSUP Pub 5552	AFM 78-54	DLAH 4215.49	MCO P4870.57A
5860	Stimulated Coherent Radiation Devices (Lasers)	SB 708-5860-1	NAVSUP Pub 5553	AFM 78-55	DLAH 4215.50	MCO P4870.58B
3415	Grinding Machines	SB 708-3415-1	NAVSUP Pub 5554	AFM 78-56	DLAH 4215.51	MCO P4870.59
3417	Milling Machines	SB 708-3417-1	NAVSUP Pub 5555	AFM 78-57	DLAH 4215.52	MCO P4870.60A
3670	Specialized Semiconductor, Microelectronic Circuit Board Manufacturing Machinery	SB 708-3670-1	NAVSUP Pub 5557	AFM 78-58	DLAH 4215.53	MCO P4870.61

"Other Plant Equipment" (OPE) is that part of plant equipment, regardless of dollar value, which is used in or in conjunction with the manufacture of components or end items relative to maintenance, supply, processing, assembly or research and development operations, but excluding items categorized as IPE.

"Provide," as used in the context of such phrases as "Government property provided to the contractor" and "Government-provided property," means either to furnish, as in "Government-furnished property," or to acquire, as in "contractor-acquired property."

45.302 Providing Facilities.

45.302-1 Policy.

(70) A facilities contract shall be terminated when the Government production and research property covered thereby is no longer required for the performance of Government contracts or subcontracts, unless such termination is detrimental to the Government's interests. The contractor shall not be granted the unilateral right, at the contractor's election, to extend the time during which the contractor is entitled to use the property provided under the facilities contract.

45.302-70 Securing Approval for Facilities Projects.

(a) The Secretaries of the Military Departments or their designees and the Directors of Defense Agencies may approve requests for Government-owned facilities projects if--

(1) The facilities projects that are funded from procurement appropriations will be approved on a location basis and shall not exceed $5 million for all property efforts (expansion, modernization, rehabilitation, etc.) during one fiscal year;

(2) It is a research and development-funded project that will not exceed $3 million per fiscal year; or

(3) The total plant and equipment investment cost to support a specific major system or subsystem (including ammunition-related project request) will not exceed $25 million during the projected acquisition or maintenance effort. (Approval authority shall not be redelegated lower than the level of Assistant Secretary.) Approval may be granted only when there is compliance with all provisions of this regulation and DoD Directive 4275.5, "Acquisition and Management of Industrial Resources."

(b) All projects which will exceed the above limitations will be submitted to the DASD(A&L)(PS) for approval.

(c) Facilities projects that involve real property transactions shall not be undertaken prior to reporting such transactions to the Committees on Armed Services of the House of Representatives and the Senate, as required by 10 U.S.C. 2662, and during the 30-day period prescribed therein. Further, Congress must be notified in advance of starting any construction regardless of cost. If not included in the annual budget, submission to all appropriate Congressional Committees will be made by using DD 1391 Forms.

45.302-71 Providing Industrial Plant Equipment (IPE).

(a) Prior to acquiring IPE, having an item acquisition cost of $10,000 or more, DoD Industrial Plant Equipment Requisition (DD Form 1419) shall be submitted to the Defense Industrial Plant Equipment Center, Memphis, Tennessee 38114, to ascertain whether existing reallocable Government-owned facilities can be utilized. If the requested facilities are numerically controlled, DD Form 1342, Section VI (page 2), shall be prepared and submitted with the DD Form 1419. No acquisition of any listed item shall be made until a certificate of nonavailability is received from the Defense Industrial Plant Equipment Center (DIPEC). However, prior to issuing a certificate of nonavailability, DIPEC shall determine if technical data (e.g., parts listings, maintenance, overhaul and repair manuals, wiring diagrams, etc.) are available. If it is determined that such data is not available at the time of issuance of the nonavailability certificate for equipment, DIPEC may request, by an appropriate instruction in block 51 of DD Form 1419, that an additional set of technical (maintenance) data be acquired with the new facilities when they are obtained. This additional set of data shall be delivered to the repository address specified by DIPEC in block 51 of DD Form 1419. In addition to acquiring technical (maintenance) data for new facilities, a description of the features of numerically controlled facilities on DD Form 1342, Section VI (page 2), shall also be acquired.

(b) Acquisition of new numerically controlled facilities shall include the requirement for the builder to complete Section VI of DD Form 1342 in triplicate, affix one copy to inside of numerical control cabinet door in a manner to preclude removal or destruction, place two copies in an envelope, and tape to door near the first copy. When warranted by the urgency of the situation, requests for screening may be submitted to DIPEC by whatever means determined expedient. When submitting urgent screening requirements other than on a DD Form 1419, the following elements of information must be furnished for each item of equipment:

(1) requisition number;

(2) PEC/NSN;

(3) description data sufficient to enable DIPEC to make an urgency determination of availability;

(4) date item required;
(5) name and address of requiring agency;
(6) contract number and program;
(7) statement as to whether item is for production or mobilization, replacement or modernization, whether item will be acquired if not available from DIPEC, and date of availability from contracting;
(8) assigned urgency rating; and
(9) estimated cost.

(c) Upon notification of availability by DIPEC, a DD Form 1419 will be submitted to DIPEC for each item accepted by the requestor. However, if DIPEC does not have the item available, or cannot furnish the item within the time specified by the requestor, DIPEC will furnish a statement of nonavailability including a certificate number. This statement will be the official Certificate of Nonavailability and will confirm that the plant equipment item has been screened against the idle inventory.

45.302-72 Providing ADPE as Government Property. The proposed acquisition of automatic data processing equipment by a contractor shall be submitted through the Administrative Contracting Officer to Headquarters, Defense Logistics Agency, ATTN: Defense Automation Resources Information Center (DARIC), Cameron Station, Alexandria, VA 22314, in accordance with DoD Manual 4160.19-M.

45.303 Providing Material.

45.303-2 Procedures. When the contractor is to be responsible for preparing requisitioning documentation, the contract shall require such documentation to be prepared in accordance with the "Manual for Military Standard Requisitioning and Issue Procedure **(MILSTRIP)**" (see Appendix H).

45.306 Providing Special Tooling.

45.306-2 Acquiring Special Tooling.

(70) Criteria for Waiving Special Tooling Provisions in Subcontracts. In determining whether rights to acquire special tooling from the subcontractors are not of substantial interest to the Government so as to permit the omission of special tooling provisions from the affected subcontracts pursuant to paragraph (k) of the clause at FAR 52.245-17, the contracting officer shall consider the factors listed in FAR 45.306-2. It is desirable that such determination be made before execution of the contract, to the extent practicable, in which case the price shall reflect the authorized omission of special tooling provisions in any affected subcontract. If this question is

presented to the contracting officer after execution of the contract, the contracting officer shall condition the determination upon securing the contractor's consent to an equitable reduction in the contract price to reflect any reduction in the price of the affected subcontracts resulting from the omission of such provisions.

PART 45--GOVERNMENT PROPERTY
SUBPART 45.4--CONTRACTOR USE AND RENTAL OF GOVERNMENT PROPERTY

45.401 Policy. Government use includes use on contracts for foreign military sales. Use of contracts for foreign military sales shall be on a rental basis unless specific approval for rent-free use is granted.

45.402 Authorizing Use of Government Production and Research Property.

(a) A contracting officer desiring to authorize use of Government production and research property under the cognizance of another contracting officer shall request the latter to give contracting officer concurrence in such use. If concurrence is denied, the matter shall be raised to a level higher than the contracting officer.

45.403 Rental--Use and Charges Clause.

(a) The Use and Charges clause shall be included in the contract under which the facilities are accountable.

(b) The policies and procedures of Recovery of Nonrecurring Costs in DoD Directive 2140.2, shall apply to the recovery of a fair share of DoD cost for special tooling and special test equipment. Where the recoupment thresholds are not met, charges for special tooling and special test equipment shall be assessed by an equitable method when determined by the cognizant contracting officer to be administratively practicable.

45.405 Contracts with Foreign Governments or International Organizations.

(a) A contractor may use Government production and research property on work for foreign governments and international organizations only upon written approval of the contracting officer having cognizance of the property. Such approval shall be granted only if such use will not interfere with foreseeable requirements of the United States, and if:

(1) The work is undertaken as a DoD Foreign Military Sale; or

(2) In the case of a direct commercial sale, the foreign country or international organization would be authorized to place the contract with the Department concerned under the Arms Export Control Act.

(b) The Use and Charges clause shall not be applicable to wholly Government-owned plants operated by private contractors on a fee basis. In such cases, any sales to foreign countries or international organizations will require an asset use charge (see (c) below) in place of the Use and Charges clause.

(c) In those circumstances where the Secretary or designee determines that a special rental agreement or the Use and Charges clause is not appropriate or is impractical, and Government facilities are to be used for foreign military sales, an asset use charge will be computed and assessed by the DoD officials responsible for preparation of the DoD Offer and Acceptance (DD Form 1513).

(d) When a particular foreign government or international organization has funded the acquisition of specific production and research property, no rental charges, asset use charges, or nonrecurring recoupments shall be assessed that foreign government or international organization for the use of such property.

(e) Requests for waivers or reduction of charges for the use of Government facilities on work for foreign governments or international organizations shall be submitted to the contracting officer who shall refer the matter through contracting channels. Approval may be granted only by the Director, Defense Security Assistance Agency for particular sales which would, if made, significantly advance U.S. Government interests in North Atlantic Treaty Organization (NATO) standardization, or foreign acquisition in the United States under coproduction arrangements.

(f) Rental/asset use charges for use of U.S. production and research property on Foreign Military Sales (FMS) and commercial sales transactions to the Government of Canada are waived for all FMS agreements accepted and commercial contracts awarded on or before 30 April 1990. This waiver is based on an understanding wherein the Government of Canada has agreed to waive its rental/asset use charges.

45.407 Non-Government Use of Plant Equipment.

(a) Non-Government use of Industrial Plant Equipment (IPE) exceeding 25% requires prior approval of the Assistant Secretary of the Army (RD&A), Assistant Secretary of the Navy (S&L), Assistant Secretary of the Air Force (RD&L), or the Director of the Defense Logistics Agency. This authority shall not be redelegated without formal DASD(A&L)(PS) approval. Requests requiring Departmental level approval should be submitted by the contractor to the cognizant contract administration office at least six weeks in advance of the projected use and shall include:

(1) The total number of active IPE items involved and the total acquisition cost thereof; and

(2) An itemized listing of active equipment having an acquisition cost of $25,000 or more, showing for each item the nomenclature, plant equipment code, year of manufacture, and the acquisition cost.

The percentage of non-Government use shall be computed on the basis of the time available for use. For this purpose the contractor's normal work schedule as represented by the scheduled production shift hours shall be used. The base time period for determining percentages for non-Government use shall be neither less than three months nor more than one year. Non-Government use of IPE located at a single plant may be averaged for all items used having a unit acquisition cost of less than $25,000. Equipment having a unit acquisition cost of $25,000 or more shall be considered on an item-by-item basis. Approving officials shall retain for periodic review, sufficient documentation of the circumstances justifying non-Government use approvals.

resentative of the Contracting Officer.

PART 45--GOVERNMENT PROPERTY
SUBPART 45.5--MANAGEMENT OF GOVERNMENT PROPERTY IN THE POSSESSION OF CONTRACTORS

45.505-5 Records of Plant Equipment.
(a) DD Form 1342 may be used as a source document for setting up prescribed records.

45.505-6 Special Reports of Plant Equipment. The contractor shall prepare a DD Form 1342 for each item of equipment identified as Industrial Plant Equipment (IPE), including items which, though part of a manufacturing system, would otherwise qualify as industrial plant equipment. Section VI (page 2) of the DD Form 1342 will be prepared for each item of IPE with numerically controlled features. General purpose components of special test equipment, which would otherwise qualify as IPE, should not be reported until there is no longer a requirement for the test equipment. The DD Form 1342, including Section VI, as appropriate, will be prepared in accordance with instructions contained in AR 700-43/NAVSUP PUB 5009/AFM 78-9/DLAM 4215.1, Management of Defense-Owned Industrial Plant Equipment (IPE), at the time (a) of receipt and acceptance of accountability by the contractor; (b) major changes as specified by DLAM 4215.1 occur in the data initially submitted to DIPEC: (c) IPE is no longer required for the purpose authorized or provided; or (d) disposal is completed. The DD Form 1342 prepared at the time IPE is no longer required for the purpose authorized or provided shall reflect all changes in data not previously reported to DIPEC. The contractor shall retain the original of each DD Form 1342 which may be used as the official property record. Copies of the DD Form 1342, including Section VI, as appropriate, shall be forwarded directly to DIPEC through the property administrator. Each DD Form 1342 will be prepared and forwarded within 15 working days after the events which created the need for its preparation and forwarding. AR 700-43/NAVSUP PUB 5009/AFM 78-9/DLAM 4215.1 is available from the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402 (see 45.301).

45.505-14 Reports of Government Property.
(a) The contractor's property control system shall provide annually the total acquisition cost of Government facilities in the following classifications:
(1) Land and rights therein;
(2) Other real property, including utility distribution systems, buildings, structures, and improvements thereto;
(3) IPE required to be reported to DIPEC;
(4) Other plant equipment (OPE).
The contractor shall furnish to the property administrator, as of

30 September of each year, a report by contract, of the total acquisition cost of Government (DoD) facilities and the quantity of the IPE for which the contractor is accountable in each of the above classifications. This shall include facilities at subcontractor plants and at alternate locations for which the prime contractor is accountable. Reports shall be prepared on DD Form 1662 (Report of Government (DoD) Facilities), and furnished to the property administrator in duplicate no later than 20 October of each year. Office of Management and Budget No. 0704-0033 has been assigned to the report.

PART 45--GOVERNMENT PROPERTY
SUBPART 45.6--REPORTING, REDISTRIBUTION, AND DISPOSAL OF CONTRACTOR INVENTORY

45.600 Scope of Subpart. In connection with reporting, redistribution, and disposal of contractor inventory, 45.71 prescribes Forms, Instructions, and Reports applicable to DoD plant clearance actions.

45.601 Definitions.

"Controlled substances" means any of the following:

(1) Narcotic (opium), depressant, stimulant (demerol), or hallucinogenic drug (marijuana) or substance;

(2) Any other drug or substance found by the Attorney General to require control as provided by Title II of the Comprehensive Drug Abuse Prevention and Control Act of 1970; or

(3) Any other drug or substance required to be controlled by the U.S. by international treaty, convention or protocol.

"Demilitarization" means the act of destroying the military offensive or defensive characteristics inherent in certain types of equipment or material so as to prevent their further military or lethal use.

"Production scrap" means material generated as a scrap in the normal production process having only a remelting or reprocessing value, including textile clippings, metal clippings, chippings, borings, turnings, and similar types of scrap, including faulty castings and forgings.

"Serviceable or usable property" means property that has reasonable prospect of use or sale either in its existing form or after minor repairs or alterations; only property in Federal Condition Codes A1, A2, A4, A5, B1, B2, B4, B5, F7, or F8 (see 45.606-5).

45.603 Disposal Methods.

45.603-70 Contractor Performance of Selected Plant Clearance Duties and Responsibilities.

(1) A DoD Component may, at its option and under the guidance in this section, provide instructions to its contract administration offices which would authorize selected contractors under its administrative cognizance to perform certain plant clearance functions under the surveillance of the contracting officer or a designated representative. Such authorizations should be considered by the DoD Component only when plant clearance personnel are stationed at the facility where the contractor's plant clearance function operates and when the DoD Component and the contractor agree that the volume of plant clearance actions warrants such an authorization.

(2) Such authorizations shall be made in writing and shall, as a minimum:

(i) Specify the plant clearance functions to be performed;

(ii) Apply to all Government contracts which contain a Government Property clause at one or more plants, as appropriate;

(iii) Specify that the authorization may be unilaterally cancelled in whole or in part by the Government through written notice by the contracting officer or a designated representative;

(iv) Provide for such direct Government participation in plant clearance cases as may be required by Government regulation or circumstances at hand. The authorization shall be approved at a level above the contract administration office as designated by the DoD Component having administrative cognizance over the contractor; and

(v) Designate the contractor authorized under (1) above to perform specified plant clearance functions as an "accredited contractor".

(3) In each case of such an authorization, the DoD Component will plan and conduct a program of surveillance which will insure effective and regular evaluations of contractor performance and prompt corrective actions when appropriate. The plant clearance case file maintained by the contractor shall be the official case file.

(4) When paragraphs (1) and (2) above are implemented, the following additional responsibilities shall be performed by the plant clearance officer:

(i) Evaluate the adequacy of contractor procedures for the performance of the tasks prescribed in (5) below. Insure that these procedures are complied with. Discrepant conditions must be promptly resolved in order for the contractor to remain accredited;

(ii) Advise the accredited contractor of the identity of redistribution screening activities and the number of copies of inventory schedules to be submitted to these activities for screening. This includes screening prescribed herein and prescribed by inventory control points and the plant clearance officer;

(iii) Review and act on the contractor's proposals to withdraw items of Government-furnished property from inventory schedules (see FAR 45.606-4);

(iv) Continuously evaluate physical, quantitative, and technical allocability of contractor inventory prior to its disposal by the accredited contractor. These evaluations shall be incorporated within the surveillance program required by (3) above. Greatest emphasis shall be placed on high dollar value property that constitutes a claim against the Government. In the event that assets are considered to be nonallocable, the contractor will be directed to delay disposition pending the contracting officer's resolution of the issue. Completion of SF 1423, Inventory Verification Survey is not required. However, the applicable questions on the SF 1423 should be answered as part of the evaluation program;

(v) Establish, with contractor assistance, criteria under which certain disposal determinations by the contractor will be reviewed and

approved or disapproved by the plant clearance officer. The criteria should be detailed in the accredited contractor's plant clearance procedures;

(vi) Complete the first endorsement section of DD Form 1640, Request for Plant Clearance, upon receipt of incoming referral cases for subcontractor inventory. Inventory schedules will be forwarded to the contractor for plant clearance. Upon case completion, obtain the case file from the contractor, prepare a DD Form 1640, and forward the file to the referring activity;

(vii) Work with the contractor, buyers, and screeners of contractor inventory to the extent required to assure that the Government shall realize maximum asset reutilization and disposal proceeds; and

(viii) Provide continuous training and assistance to the contractor as requested or as necessary.

(5) The accredited contractor will perform the following designated tasks which are identified within the referenced paragraphs as plant clearance officer functions. The accredited contractor shall:

(i) Assign the Automatic Release Date (ARD) and screening release date (SRD), initiate screening prescribed herein or as prescribed by the plant clearance officer, and effect resulting transfer and donation actions (see FAR 45.608, 45.609);

(ii) Withdraw items, except for Government-furnished property, from inventory schedules without plant clearance officer approval and notify the affected screening activities. Plant clearance officer approval will be obtained for withdrawal of Government-furnished property from inventory schedules (see FAR 45.606-4);

(iii) Assure acceptability of inventory schedules. DD Form 1637, Notice of Acceptance of Inventory, is not required but may be used for internal contractor case coordination (see FAR 45.606-3);

(iv) Suspend disposition of property when assets are determined to be nonallocable by the plant clearance officer (see FAR 45.606-3);

(v) Arrange for the physical inspection of property by prospective transferees as appropriate;

(vi) Determine the method of disposal under established priorities (see FAR 45.603) and document disposal decisions and actions (see FAR 45.609, 45.610, 45.611, 45.613). Use of the DD Form 1641, Disposal Determination Approval, is not required as long as equivalent documentation is maintained. The plant clearance officer shall be notified in writing in advance in each instance when the contractor is bidding on property to be sold under FAR 45.610. Sales under FAR 45.610-3 shall not be conducted by an accredited contractor;

(vii) Account for disposal of all contractor inventory and application of proceeds. SF 1424, Inventory Disposal Report, or a contractor form containing comparable data elements is required to be submitted to the plant clearance officer (see FAR 45.610-3, 45.615);

(viii) Maintain the donable property file (see FAR 45.609);
(ix) Release property to eligible donees (see FAR 45.609);
(x) Properly prepare, approve, sign, and maintain official plant clearance files and required forms including:
(A) Plant clearance case number (see 45.7102-4);
(B) DD Form 1635, Plant Clearance Case Register, or comparable contractor document (see 45.7101-8);
(C) SF 120, Reporting of Excess Personal Property (see FAR 45.608-2 and FAR 45.608-8);
(D) DD Form 1342, DoD Property Record, and transmittal letter (see 45.7102-3); and
(E) DD Form 1348-1, DoD Single Line Item Release/Receipt Document, for transfers (turn-ins) to the Defense Property Disposal Service or inventory control points; and
(xi) All completed case files and subcontractor inventory cases received for plant clearance shall be retained by the contractor in the official case file.

45.604 Restrictions on Purchase or Retention of Contractor Inventory.
(70) A contractor, when authorized to sell contractor inventory, shall not sell such inventory to persons known by him to be: (1) a civilian employee of the Department of Defense or the United States Coast Guard whose duties include any functional or supervisory responsibility for or within the Defense Property Disposal Program, or for the disposal of contractor inventory; (2) a member of the Armed Forces of the United States, including the United States Coast Guard, whose duties include any functional or supervisory responsibility for or within the Defense Property Disposal Program, or for the disposal of contractor inventory; or (3) an agent, employee or immediate member of the household of personnel in (1) and (2) above.
(71) The authority of a contractor to approve a sale, purchase, or retention at less than cost, by a subcontractor, and the authority of a subcontractor to sell, purchase, or retain at less than cost, contractor inventory with the approval of the next higher-tier contractor does not include authority to approve:
(1) a sale by a subcontractor to the next higher-tier contractor or to an affiliate of such contractor or of the subcontractor; or
(2) a sale, purchase, or retention at less than cost, by a subcontractor affiliated with the next higher-tier contractor.
(72) Each excluded sale, purchase, or retention requires the written approval of the plant clearance officer.
(73)(1) Contractor inventory possessing military offensive or defensive characteristics, not required within the Department of Defense, shall be demilitarized by the contractor in accordance with Defense Demilitarization Manual, DoD 4160.21-M-1. In unusual cases, the purchaser may be authorized by the contracting officer to perform

the demilitarization in accordance with DoD 4160.21-M-1; provided, however, that in no case shall such authorization be granted to the purchaser if the inventory is dangerous to life or property.

(2) Contractor inventory classified by reason of military security, unless the classification is removed by proper authority, shall be disposed of in accordance with applicable security regulations or as otherwise directed by the contracting officer.

(3) Contractor inventory dangerous to public health or safety shall not be donated or otherwise disposed of unless rendered innocuous or until adequate safeguards have been provided.

45.606-3 Acceptance.

(a) If the schedules are acceptable, the plant clearance officer shall, within 15 days, execute and transmit to the contractor a DD Form 1637, Notice of Acceptance of Inventory.

45.606-5 Instructions for Preparing and Submitting Schedules of Contractor Inventory. (See 45.7001-4 for specific duties and responsibilities of DoD plant clearance officers.)

(d) General Instructions for Completing Forms.

(4) For the purposes of indicating condition of the property, the codes indicated below should be used in combination with the disposal condition codes (1-9, X, and S). Use a letter and a number (such as A1 or F7) or two letters (such as SS):

A. New, used, repaired, or reconditioned property which is serviceable and issuable to all customers without limitations or restriction. Includes material with more than 6 months shelf-life remaining.

B. New, used, repaired, or reconditioned property which is serviceable and issuable for its intended purpose but which is restricted from issue to specific units, activities, or geographical areas by reason of its limited usefulness or short service-life expectancy. Includes material with 3 through 6 months shelf-life remaining.

F. Economically reparable property which requires repair, overhaul, or reconditioning. Includes reparable items which are radioactively contaminated.

H. Property which has been determined to be unserviceable and does not meet repair criteria.

S. Property that has no value except for its basic material content.

45.607 Scrap.

45.607-70 Pre-Inventory Scrap Determinations. The contractor may request the plant clearance officer to make a pre-inventory scrap

determination of inventory considered by the contractor to be without value except as scrap. These pre-inventory scrap determinations shall be based on on-site surveys. If the contractor's scrap recommendation is approved, the contractor may make a single descriptive entry on an inventory schedule covering that property and indicating its approximate total cost. If the plant clearance officer determines that any of the property listed by the contractor as scrap is serviceable, usable, or salvable, the contractor shall, in accordance with this determination, submit appropriate inventory schedules. If the determination is made subsequent to the submission of a scrap inventory schedule, the contractor shall be required to submit revised inventory schedules in proper form.

45.607-71 Segregation. Property determined to be scrap shall be segregated by the contractor to the extent necessary to assure the highest net proceeds. In appropriate cases, when approved by the plant clearance officer, these sales may be consolidated with the contractor's sales of scrap generated from other work.

45.607-72 Contractor's Approved Scrap Procedure.

(a) When a contractor has an approved scrap procedure, certain property may be routinely disposed of in accordance with that procedure and not processed under this Part. Production scrap and production spoilage may be disposed of through the contractor's approved scrap procedure. In addition, worn, broken, mutilated, or otherwise rejected parts excess to overhaul and repair contracts, may be similarly processed with the approval of the plant clearance officer.

(b) A plant clearance case shall not be established for property which is disposed of through the contractor's approved scrap procedure.

(c) The contractor's scrap and salvage procedures, particularly the sales aspects thereof, shall be reviewed by the plant clearance officer prior to its approval by the property administrator. The plant clearance officer shall assure that the procedure contains adequate requirements for inspection and examination of items to be disposed as scrap. When the contractor's approved scrap procedure does not require physical segregation and disposition of Government-owned from contractor-owned scrap, care shall be exercised to assure that a contract change, which generates a large quantity of property, does not result in an inequitable return to the Government. In these cases, a determination shall be made as to whether separate disposition of Government scrap would be appropriate.

(d) Scrap, other than that disposed of through the contractor's approved scrap procedure, shall be reported on appropriate inventory schedules for disposition in accordance with the provisions of FAR Part 45 and this supplement.

(e) Silver, gold, platinum, palladium, rhodium, iridium, osmium and ruthenium; scrap bearing such metals; and items containing recoverable quantities thereof will be reported to the Defense Property Disposal Service, DPDS-R, Federal Center, Battle Creek, Michigan 49016, for disposition instructions.

45.608 Screening of Contractor Inventory.

45.608-1 General.

(b) The 75th day shall be designated as the Automatic Release Date (ARD) by the plant clearance officer. The full 90-day period shall be designated as the Screening Completion Date (SCD). Plant clearance officers will designate two dates on all screening documents, the 75th day as the ARD and the 90th day as the SCD, neither of which shall be extended.

45.608-7 Reimbursement of Costs for Transfer of Contractor Inventory. Costs incident to movement of IPE under the direction and control of the Defense Industrial Plant Equipment Center shall be borne by the Defense Logistics Agency.

45.608-70 Contractor Inventory Redistribution System (CIRS). Serviceable and usable contractor inventory of the type listed on SF Forms 1428, Inventory Schedule B or SF Forms 1434, Inventory Schedule E, having a National Stock Number (NSN) and a line item acquisition value (acquisition value of each unit times the number of units) in excess of $50, or having no NSN and a line item acquisition value in excess of $500 shall be processed as follows:

(a) the 90-day screening period normally applies and the plant clearance officer establishes the ARD and SCD; and

(b) two copies of the SF Form 1428, SF Form 1434, or authorized substitutes will be transmitted by Standard Form 120 to the Defense Industrial Plant Equipment Center (DIPEC), Attn: DIPEC-SSB; and

(c) DIPEC will return an annotated copy of each SF Form 1428 or 1434 received to the plant clearance officer with a Notification of Receipt form attached. This notification will inform the plant clearance officer which items were processed, are not accepted, or are now available for local area screening; and

(d) property submitted for CIRS-processing will be subjected to a 30-day DoD screening period. The requiring activity within the requiring Department shall have requisitioning priority over other activities within that requiring Department and over the contracting Department when the requiring and contracting Departments are different. DIPEC reports items not requisitioned to the General Services Administration on the 31st day, unless the plant clearance officer provided special instructions to the contrary on the Standard Form 120; and

(e) DIPEC will issue shipping instructions on DD Form 1348-1 to the plant clearance officer. The plant clearance officer shall reroute requisitions received directly from the requisitioner to DIPEC during the first 45 days of the screening period. Requisitions received by DIPEC or by the plant clearance officer after the 45th day of the screening cycle shall be forwarded directly to the General Services Administration; and

(f) the plant clearance officer will instruct the contractor to send one copy of the completed DD Form 1348-1 to DIPEC, Attn: DIPEC-SSB, when shipment has been made; and

(g) unless the contracting officer directs otherwise, motor vehicles generated under Army and Navy contracts shall not be screened through CIRS.

45.608-71 Procedures for Industrial Plant Equipment.

(a) Reporting Idle Industrial Plant Equipment. Industrial plant equipment (IPE) having an acquisition cost of $5,000 or more shall be listed on DD Form 1342, DoD Property Record. The DD Form 1342 shall be prepared by the contractor and submitted to the assigned Government property administrator for appropriate review and transmittal to the plant clearance officer. If the IPE has numerically controlled features, the contractor shall prepare and submit DD Form 1342, Section VI (page 2), Numerically Controlled Machine Data. Upon receipt of an acceptable DD Form 1342, the plant clearance officer will designate the 75th day from that date as the ARD, with the 90th day from that date as the SCD. The ARD will be entered in block 24 of the DD Form 1342 and shall not be extended, except as provided in (e) below. The plant clearance officer will forward 2 copies of the DD Form 1342 to the Defense Industrial Plant Equipment Center, Memphis, TN 38114, for all IPE in condition codes other than "X." Condition code "X" IPE shall be processed in accordance with agency procedures. The DD Form 1342 shall be forwarded to DIPEC within 15 working days after becoming idle. No other distribution of this form will be made by the plant clearance officer.

(b) Screening--First Through 30th Day. DIPEC shall screen excess IPE against all requirements submitted by Department of Defense activities, including Department of Defense reserve requirements, with priority being given to requirements of the owning Department through the 30th day. DIPEC will issue a shipping instruction containing appropriate accounting, funding, transportation, routing recommendations, and preservation instructions for items selected to the appropriate contract administration office.

(c) Screening--31st Through 75th Day. On the 31st day, DIPEC will forward excess data to the applicable General Services Administration regional office for Federal utilization screening through the 75th day. During the period from the 31st through the

75th day, the General Services Administration will approve requests from any agency of the Government on a "first come-first served" basis, and will approve and forward transfer orders containing appropriate accounting, funding, transportation, routing recommendations, and preservation instructions to the appropriate contract administration office. The General Service Administration will forward copies of the approved transfer orders to DIPEC.

(d) Screening--76th Through 90th Day. During this period the General Services Administration will provide for the screening of all remaining IPE for possible donation. The General Services Administration will receive and approve donation applications for IPE and will forward approved donation applications, containing appropriate accounting, funding, transportation, routing recommendations, and preservation instructions to the appropriate contract administration office. The General Services Administration will forward copies of the approved donation applications to DIPEC.

(e) If a Department of Defense requirement develops after the 90th day and the item is still available, the item will be shipped against such requirement, unless the plant clearance officer has justified and compelling reasons for not making the shipment.

(f) Items of plant equipment with an acquisition cost of less than $5,000, and items of plant equipment with an acquisition cost of more than $5,000 not qualifying as IPE, as defined in 45.301, shall not be reported to DIPEC but shall be reported and screened in accordance with FAR 45.608 and this supplement.

(g) The plant clearance officer shall, when IPE is transferred use-to-use or use-to-storage within DoD, assure that a copy of the completed shipping document is submitted to DIPEC. Sales of IPE that is excess to ownership but not to DoD requirements that is sold by GSA shall be reported to DIPEC in accordance with agency instructions.

45.609 Donations.

(70)(1) Classification of eligible donees in order of precedence and approval requirements are:

(i) for property schedules transmitted to GSA--

(A) Public Airports. Donations approved during the first five days of the donation screening period. State or local public airport donations require approval of an appropriate official of the Federal Aviation Administration, Department of Transportation, and GSA.

(B) Service Educational Activities (SEA). SEA's have the same order of precedence as in (2) below. Approval required of their national headquarters and GSA.

(C) Educational, Public Health, and Civil Defense Institutions and Organizations. Donations approved on a first-come, first-served

basis with public airports and SEAs, during the last 10 days of the donation screening period. GSA has the over-all responsibility for selecting property determined to be usable and necessary for educational, public health and civil defense purposes, including research for any such purposes. Surplus property is screened and distributed for educational, public health, and civil defense purposes by State Agencies for Surplus Property (SASP). Approval of GSA is required.

(ii) For property screened in accordance with FAR 45.608, public airports, SEAs, and SASP screen and select property for donation approval by GSA on a first-come, first-served basis.

(iii) Public Bodies. Surplus property may be donated to public bodies in lieu of destruction or abandonment in accordance with FAR 45.611.

(2) In addition to the activities indicated in (1) above, a Department may donate, without expense to the United States, certain material not needed by the Department of Defense to veterans' organizations, soldiers' monument associations, state museums, and incorporated museums operated and maintained only for educational purposes, whose charter denies them the right to operate for profit. For guidance as to limitations and requirements for donation to these activities, see Chapter X, para. F, DoD 4160.21-M.

45.610 Sale of Surplus Contractor Inventory.

45.610-1 Responsibility.

(a) Property under DoD Control.

(1) General.

(i) It is the Department of Defense policy that when surplus contractor inventory is to be disposed of by means of sale, such sale will be conducted by the contractor in possession in accordance with procedures provided in this Section. The contractor is required to use best efforts to sell contractor inventory in the manner, at the times, to the extent, and at the prices approved by the plant clearance officer. The contractor is not required to extend credit to any purchaser.

(ii) Surplus contractor inventory included in the contractor's inventory schedules which has not been utilized or donated under FAR 45.609, or retained at cost pursuant to FAR 45.605, shall be sold in accordance with (2) below at any time after notification by the plant clearance officer that screening has been accomplished. Any such purchase, retention, or sale shall be subject to the approval of the plant clearance offficer.

(iii) Description of Property. Description of property must be adequate for identification by prospective bidders. Accuracy is essential and commercial terminology desirable. The original

manufacturer and brand name shall be included, if appropriate. When property is boxed or packaged, information as to type of packaging shall be included.

(iv) Condition. Condition shall be stated as "used" or "unused" and shall not be described as new. If unused property is still in manufacturer's original containers, a statement to that effect shall be included. Appropriate qualifying statements shall supplement the basic noun description, i.e., "well preserved," "some surface rust," "repairs required," etc. Condition codes shall not be used. Because of its non-specific meaning to the trade, the term "salvage" risks downgrading of the property in the bidder's viewpoint and shall not be used.

(v) Lotting shall be in accordance with the following:

(A) unused items shall be lotted by make or manufacturer, except when quantities or dollar values are small;

(B) commercially similar items shall be lotted together when practicable;

(C) used and unused items shall be lotted separately, unless the quantity, value, or nature is such that it is uneconomical to sell separately;

(D) within the bounds of economical considerations, the size of lots shall be influenced by an effort to encourage bidding by small businesses or individuals;

(E) no lot shall be so small that the administrative cost of selling will be disproportionate to the anticipated proceeds;

(F) an alternate bid for groups of items or for the entire offering may be solicited by use of an additional item described as follows:

Item.....(Alternate Bid)
This item consists of all property listed and described in Items.....to....., inclusive. Award under this item may be made only if the highest acceptable bid on this item is equal to, or greater than, the total of the highest acceptable bids on Items.....to....., inclusive.

(vi) Basis of Sale shall be:

(A) Unit Price Basis. Items offered for sale shall require the bid price to be stated in terms of the quantity or weight generally applied by industry in the commercial sale of such items.

(B) Lot Price Basis. When a sales offering is made on a lot price basis, bids shall be requested only for the entire lot. Use of the lot prices basis shall be held to a minimum, since it precludes adjustments. The lot price basis shall be used only when property cannot be sold by unit measure or the potential monetary recovery is small.

(vii) Format of Invitation. In large sales, a summary list of items offered shall be set forth and used as an item bid sheet, with detailed item descriptions on attached sheets.

(viii) Bidder's Lists. The plant clearance officer shall assure that commodity bidder's lists sufficient to obtain adequate competition in the sale of contractor inventory are maintained. The plant clearance officer may obtain additional listings, as required, from the Defense Property Disposal Service (DPDS-R), Federal Center, Battle Creek, Michigan 49016. Use of listings maintained by DPDS is encouraged when extremely large quantities of property, special commodities, or unusual geographic location is involved.

(ix) Auction, Spot Bid, and Retail Sales. Auction, spot bid, and retail sales shall not be utilized for selling contractor inventory, unless approved on an individual case basis by the departmental headquarters of the administering activity.

(x) Market Impact. Contracting Officers or plant clearance officers shall submit data to the Defense Logistics Services Center (DLSC) relative to the proposed sale of machine tools of any one type on hand at any single location in minimum condition A1, A2, or A4, with a total acquisition cost exceeding $250,000. Sales data shall include the Plant Equipment Code (PEC) number, noun description, quantity, location of property, and the proposed method of sale. DLSC shall advise the contracting officer or plant clearance officer within five working days whether or not sale proposal is approved. Priority for sales approval shall be given in those instances when plant clearance or other expedited actions are involved.

(2) Competitive Sales.

(i) General. Surplus contractor inventory shall be offered for sale on a competitive basis except as provided in (3) below. To the extent feasible, subcontractors and suppliers should be solicited when additional competition is likely to result. The plant clearance officer shall provide the contractor with instructions relative to the method of soliciting bids and the basis for offering the property for sale (i.e., serviceable or scrap). In determining the sales method to be used, the plant clearance officer shall consider the expected sales proceeds (based on previous experience and current market) versus the cost of conducting the sale. When it is determined that an individual sale will be uneconomical, the material to be sold shall be combined with other material offered for sale, disposed of through the contractor's approved production generated scrap disposal procedure or abandoned. Case files will be documented to show the basis for the decision. The contractor's overall program, including all forms and procedures shall be evaluated by the plant clearance officer and shall be subject to surveillance. To the extent necessary, the plant clearance officer may reserve the right to approve individual sales offerings prior to distribution. When the plant clearance officer determines that sale services are required, such services will be arranged for by the plant clearance officer directly with the organization requested to provide the services. The plant clearance

officer will justify and document this need. These documents shall be a part of the plant clearance case file. The agreement reached will provide for the Defense Property Disposal Office or General Services Administration Regional Office to return total proceeds to the plant clearance officer for crediting in compliance with FAR 45.610-3.

(ii) Solicitation of Bids. Contractors shall solicit bids by formal invitations, unless informal bid procedures have been approved by the plant clearance officer as provided in (B) below:

(A) Formal Bid Procedures.

Bids shall be solicited a minimum of 15 calendar days in advance of the opening of bids to allow bidders an adequate opportunity to inspect the property and prepare and formally submit bids;

Invitations shall be circulated to a sufficient number of prospective bidders to assure wide competition, including the original suppliers and those prospective bidders designated by the plant clearance officer and the contractor;

In addition to mailing or delivering a notice of the proposed sale to all prospective bidders, the contractor may supplement this sales method by--

displaying a notice of the proposed sale in appropriate public places;

displaying a notice of the proposed sale in appropriate trade journals or magazines; or

publishing a notice of the proposed sale in a newspaper of general circulation in the locality in which the property is located, when the results of such paid commercial advertising is expected to justify the additional expenses involved.

When the acquisition cost of property to be sold at one time, at one place, is $250,000 or more, notice of each such proposed sale shall be transmitted to the U.S. Department of Commerce, Commerce Business Daily Office, Sales Section, P.O. Lock Box 5999, Chicago, Illinois, 60680. The notice shall be sent at as early a date as possible in advance of the sale but at least 20 days prior to the date when the bids will be opened, or, in the case of spot bid or auction sale, when the sale will be conducted. Such notice shall be transmitted by fastest mail available and shall be in synopsis form suitable for printing directly from the text so transmitted without editing or condensing. Double space lines will be used to describe each sales action; and the length of the line should be approximately 65, but not to exceed 69 character spaces and will contain the following information in the order listed: the name and address of the contractor who will issue the invitation; the name or title, address, and telephone number of the official from whom copies of the sales offering and other information can be obtained; a description of the property to be sold; when deemed desirable, the total estimated acquisition cost; the number of the invitation or sale; the date of

the sale or bid opening, the types of sale, i.e., sealed bid, spot bid, or auction; and the location(s) of the property. The utmost care should be exercised in describing the types of property to be sold in order to assure interest by the maximum number of potential buyers but, at the same time, condense the information so that minimum space in the Department of Commerce publication will be required for printing. Where the acquisition cost is less than $250,000 such notice may be transmitted, when considered desirable, in accordance with the procedures prescribed above.

(B) Informal Bid Procedures. When the amount or value of the property is not large enough to warrant preparation of a formal notice of the proposed sale or other special circumstances are present, invitations to bid may, with the approval of the plant clearance officer, be issued orally, by telephone or by other informal media, so long as the element of competition is maintained and each such sale is fully documented to include a record of solicitations and written confirmation of informal bids. Any bid by the contractor or its employees shall be submitted to the plant clearance officer prior to solicitation of bids by the contractor from other prospective bidders.

(iii) Formal Invitations. Sale by formal invitation shall include as a minimum general sale terms and conditions provided in 45.7102-6(a) and, when necessary, special conditions in 45.7102-6(b). The plant clearance officer or representative shall be present to witness bid openings. Within two working days after bid opening, the contractor shall submit to the plant clearance officer two copies of an abstract of all bids, signed by the witnessing Government representative. All awards shall be subject to the approval of the plant clearance officer as indicated in (iv) below.

(iv) Bid Reservations. All invitations for bid shall reserve the right to reject any or all bids and shall require payment of the full purchase price prior to delivery of the property to the purchaser.

(v) Approval of Sale. Bids shall be evaluated by the plant clearance officer to establish that the sale price is fair and reasonable in the light of reasonable knowledge or test of the market, due regard being given to current prices for products for which quotations are published and to the circumstances, nature, condition, quantity, and location of the property. Current market price appraisal or price received may be obtained from DPDS upon request. Award shall be approved to that responsible bidder whose bid is most advantageous to the Government, price and other factors considered. Award shall not be approved to any bidder who would not be eligible to enter into a sales contract with the Department of Defense in accordance with the provisions of the Consolidated List of Debarred, Suspended, and Ineligible Contractors. If it is determined that a compelling reason exists to make an award to a contractor on the Consolidated List, the plant clearance officer shall request approval from the departmental headquarters of the administering activity.

(vi) Award by Contractor. The plant clearance officer shall notify the contractor within five working days of the bidder to whom an award shall be made. The contractor shall make the award, collect the proceeds of sale, and release the property to the purchaser. The contractor shall provide the plant clearance officer with evidence of delivery reflecting actual quantities released to the purchaser.

(3) Negotiated Sales.

(i) Negotiated sales, including purchases or retentions at less than cost by the contractor, may be made when the contracting department or the plant clearance officer determines and documents in accordance with and 45.613(d) and FAR Subpart 1.7, as appropriate, that the use of this method of sale is essential to expeditious plant clearance, or is otherwise justified on the basis of circumstances enumerated below, provided, that the Government's interests are adequately protected. Negotiated sales, including purchases or retentions at less than cost by the contractor, shall be at prices which are fair and reasonable and not less than the proceeds which could reasonably be expected to be obtained if the property was offered for competitive sale. Specific conditions justifying negotiated sales are:

(A) scientific equipment allocated to terminated research and development contracts with educational institutions;

(B) when no acceptable bids have been received as a result of competitive bidding under a suitably advertised sale;

(C) when property is of such small value that the proceeds to be derived would not warrant the expense of a formal competitive sale;

(D) when the disposal will be to states, territories, possessions, political subdivisions thereof, or tax-supported agencies therein, and the estimated fair market value of the property and other satisfactory terms of disposal are obtained;

(E) when the specialized nature and limited use potential of the property would create negligible bidder interest;

(F) when removal of the property would result in a significant reduction in value, or the accrual of disproportionate expenses in handling; or

(G) when it can be clearly established that such action is essential to the Government's interests.

(ii) In those instances when the contracting department has concluded that it is appropriate to sell production equipment to the contractor in possession by means of noncompetitive negotiated sale, the department will provide the CAO with the required sales justification including any special sales provisions that may be appropriate.

(4) Applicability of Antitrust Laws. When contractor inventory with an acquisition cost of $3,000,000 or more (or any patents, processes, techniques, or inventions, irrespective of cost) is to be sold or otherwise disposed of to private interest, the Department

concerned shall promptly notify the Attorney General and the Administrator, General Services Administration, of the proposed disposal and the probable terms or conditions thereof. Prior to approving or effecting the proposed disposition, the plant clearance officer shall obtain antitrust clearance by transmitting the following information relative to the proposed sale through departmental channels of the administering activity for submission by that activity to the Department of Justice and the General Services Administration: Report Control Symbol DD DR&E(AR) 1492 has been assigned for this reporting requirement.

(i) location and description of property (specifying the tonnage, if scrap);

(ii) proposed sale price of property (explaining the circumstances if proposed purchaser was not highest bidder);

(iii) acquisition cost of property of Government;

(iv) manner of sale, indicating whether by--

(A) sealed bid (specifying number of purchasers solicited and bids received),

(B) auction or spot bid (stating how sale was advertised), or

(C) negotiation (explaining why property was not offered for sale by competitive bid);

(v) proposed purchaser's name, address, and trade name (if any), under which proposed purchaser is doing business;

(vi) if a corporation, give name of state and date of incorporation, and name and address of--

(A) each holder of 25 percent or more of the corporate stock,

(B) each subsidiary, and

(C) each company under common control with proposed purchaser;

(vii) if a partnership, give--

(A) name and address of each partner, and

(B) other business connections of each partner;

(viii) nature of proposed purchaser's business, indicating whether its scope is local, statewide, regional, or national;

(ix) estimated dollar volume of sales of proposed purchaser (as of latest calendar or fiscal year);

(x) estimated net worth of proposed purchaser; and

(xi) proposed purchaser's intended use of property.

Disposition shall be withheld pending receipt of advice from the Attorney General as to whether the proposed disposal action would tend to create or maintain a situation inconsistent with the antitrust laws. If the Attorney General advises that the proposed disposition would tend to create or maintain a situation inconsistent with the antitrust laws, such disposition will not be made. When property with a total acquisition cost of $3,000,000 or more is offered for sale on a competitive bid basis, the condition of sale specified in 45.7102-6(b)(8) shall be included in the invitation for bid. When the sale is

not competitive, the prospective purchaser shall be informed that final consummation of the sale is subject to determination by the Attorney General. The purchaser on either a competitive or noncompetitive sale shall be required to complete a questionnaire, providing the information outlined in (v) through (xi) above.

(5) Foreign Contractor Inventory.

(i) To prevent diversion, transshipment, or re-export of contractor inventory located in foreign countries to prohibited destinations and the use of such inventory adversely to the interests of the United States, the sale or other disposition of such inventory by the contractor, including sales to foreign governments, shall be made in accordance with (ii) and (iii) below.

(ii) Sales contracts or other documents for passing title to foreign contractor inventory shall contain the following certificate:

> The Purchaser certifies that the property covered by this contract will be used in (insert name of country). In the event resale or export is to be effected by the Purchaser of any of the property, acquired at a price in excess of One Thousand United States Dollars ($1,000) or its equivalent in other currency at the official rate of exchange, the Purchaser agrees to obtain the approval of ..... (insert name and address of Sales Contracting Officer).

(iii) The sales contracting officer shall approve sales contracts and requests for approval of resales or exports only if:

(A) the proposed purchaser's name does not appear on the Consolidated List of Debarred, Suspended and Ineligible Contractors, and

(B) if the sales contract contains a provision prohibiting exports by purchasers and subpurchasers to communist areas, as listed in FAR 25.702.

(iv) Any disposals of foreign contractor inventory by the United States Government, as distinguished from disposal by a contractor, shall be in accordance with the security trade control regulation on foreign excess sales, and regulations dealing with integrity and reliability checks.

(v) Generally, disposal activities of the Military Departments shall be utilized to accomplish the disposition of surplus contractor inventory located in foreign countries except Canada. Contractor-conducted sales may be authorized, provided the interests of the Government are adequately protected.

45.610-3 Proceeds of Sale.

(70) When payments are due the contractor under the applicable contract, and unless otherwise provided in the contract, the proceeds of any sale, purchase, or retention shall be credited to the Government as part of the settlement agreement, or otherwise credited

to the price or cost of the work covered by the contract, or applied in the manner directed by the contracting officer. The plant clearance officer will maintain an open suspense record until the plant clearance officer has verified that credit has in fact been applied, unless another Government representative has specifically assumed this responsibility.

(71) Proceeds from contractor-conducted sales which have not been credited as provided in (70) above shall be collected by the contractor and remitted to the plant clearance officer.

(72) All proceeds of sale remitted to the plant clearance officer shall be delivered to the designated disbursing officer by means of DD Form 1131, Cash Collection Voucher, within two working days after receipt. Transmittals shall identify the acquisition contract by number and name of the contractor.

45.613 Property Disposal Determinations. Written determinations supporting disposal actions in the following categories shall be made and placed in the plant clearance case file:

(a) salvage determination;
(b) scrap determinations (not required for production scrap);
(c) abandonment and/or destruction determinations;
(d) disposal by noncompetitive sale; and
(e) other actions considered necessary by the plant clearance officer.

Determinations shall be recorded on DD Form 1641, Disposal Determination/Approval.

PART 45--GOVERNMENT PROPERTY
SUBPART 45.70--APPOINTMENT OF PROPERTY ADMINISTRATOR

45.7001 Appointment of Property Administrator.

45.7001-1 Selection, Appointment, and Termination. The selection, appointment and termination of appointment of property administrators shall be made in writing by the Head of a Contracting Activity or designee for the Defense Logistics Agency and by the head of the contract administration office or designee for the other Departments. In selecting qualified property administrators, the appointing authority shall consider experience, training, education, business acumen, judgment, character, and ethics.

45.7001-2 Evaluation Criteria. In considering experience, training and education, the following shall be evaluated:

(a) Experience in accounting, material control, inventory control and allied functions;

(b) Formal education or specialization in such areas as evaluating, monitoring, administering, or coordinating industrial property programs or implementing plans and policies in support of diversified property control system; and

(c) Knowledge of the provisions of this and other applicable regulations.

45.7001-3 Reserved.

45.7001-4 Duties and Responsibilities of Plant Clearance Officer. The plant clearance officer shall be responsible for:

(a) Providing the contractor with instructions and advice regarding the proper preparation of inventory schedules;

(b) Accepting or rejecting inventory schedules and DD Form 1342;

(c) Conducting or arranging for inventory verification;

(d) Initiating prescribed screening and effecting resulting transfer and donation actions;

(e) Final plant clearance of contractor inventory;

(f) Pre-inventory scrap determinations, as appropriate;

(g) Evaluating the adequacy of the contractor's procedures for effecting property disposal actions;

(h) Determining method of disposal;

(i) Surveillance of contractor-conducted sales;

(j) Accounting for all contractor inventory reported by the contractor;

(k) Advising and assisting, as appropriate, the contractor, inventory control manager, other federal agencies, or higher headquarters in all actions relating to the proper and timely disposal of contractor inventory;

(l) Approving method of sale, evaluating bids, and approving sale prices for contractor-conducted sales;

(m) Recommending the reasonableness of selling expenses on contractor-conducted sales;

(n) Securing anti-trust clearance, as required; and

(o) Advising the contracting officer on all property disposal matters.

space property). It excludes Government material, special test equipment, special tooling, and facilities.

"Facilities," as used in this subpart and when used in other than a facilities contract, means property used for production, maintenance, research, development, or testing. It includes plant equipment and real property (see 45.101). It does not include material, special test equipment, special tooling, or agency-peculiar property. When used in a facilities contract, the term includes all property provided under that contract.

"Facilities contract," as used in this subpart, means a contract under which Government facilities are provided to a contractor or subcontractor by the Government for use in connection with performing one or more related contracts for supplies or services. It is used occasionally to provide special tooling or special test equipment. Facilities contracts may take any of the following forms:

(a) A facilities acquisition contract providing for the acquisition, construction, and installation of facilities.

(b) A facilities use contract providing for the use, maintenance, accountability, and disposition of facilities.

(c) A consolidated facilities contract, which is a combination of a facilities acquisition and a facilities use contract.

"Government production and research property," as used in this subpart, means Government-owned facilities, Government-owned special test equipment, and special tooling to which the Government has title or the right to acquire title.

"Material," as used in this subpart, means property that may be incorporated into or attached to a deliverable end item or that may be consumed or expended in performing a contract. It includes assemblies, components, parts, raw and processed materials, and small tools and supplies that may be consumed in normal use in performing a contract.

"Nonprofit organization," as used in this subpart, means any corporation, foundation, trust, or institution operated for scientific, educational, or medical purposes, not organized for profit, and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

"Nonseverable," as used in this subpart, when related to Government production and research property, means property that cannot be removed after erection or installation without substantial loss of value or damage to the property or to the premises where installed.

45.302 Providing facilities.

45.302-1 Policy.

(a) Contractors shall furnish all facilities required for performing Government contracts except as provided in this subsection. Agencies shall not furnish facilities to contractors for any purpose, including restoration, replacement, or modernization, except as follows:

(1) For use in a Government-owned, contractor-operated plant operated on a cost-plus-fee basis.

(2) For support of industrial preparedness programs.

(3) As components of special tooling or special test equipment acquired or fabricated at Government expense.

(4) When, as a result of the prospective contractor's written statement asserting inability or unwillingness to obtain facilities, the agency head or designee determines that the contract cannot be fulfilled by any other practical means or that it is in the public interest to provide the facilities. If the contractor's inability to provide facilities is due to insufficient lead time, the Government may provide existing facilities until the contractor's facilities can be installed.

(5) As otherwise authorized by law or regulation.

(b) Agencies shall not—

(1) Furnish new facilities to contractors unless existing Government-owned facilities are either inadequate or cannot be economically furnished;

(2) Use research and development funds to provide contractors with new construction or improvements of general utility, unless authorized by law; or

(3) Provide facilities to contractors solely for non-Government use, unless authorized by law.

(c) Competitive solicitations shall not include an offer by the Government to provide new facilities, nor shall solicitations offer to furnish existing Government facilities that must be moved into a contractor's plant, unless adequate price competition cannot be otherwise obtained. Such solicitations shall require contractors to identify the Government-owned facilities desired to be moved into their plants.

(d) Government facilities with a unit cost of less than $10,000 shall not be provided to contractors unless—

(1) The contractor is a nonprofit institution of higher education or other nonprofit organization whose primary purpose is the conduct of scientific research;

(2) A contractor is operating a Government-owned plant on a cost-plus-fee basis;

(3) A contractor is performing on a Government establishment or installation;

(4) A contractor is performing under a contract specifying that it may acquire or fabricate special tooling, special test equipment, and components thereof subsequent to obtaining the approval of the contracting officer; or

(5) The facilities are unavailable from other than Government sources.

45.302-2 Facilities contracts.

(a) Facilities shall be provided to a contractor or subcontractor only under a facilities contract using the appropriate clauses required by 45.302-6, except as provided in 45.302-3.

(b) All facilities provided by a contracting activity for use by a contractor at any one plant or general location shall be governed by a single facilities contract, unless the contracting officer determines this to be impractical. Each agency should consolidate, to the maximum practical extent, its facility contracts covering specific contractor locations.

(c) No fee shall be allowed under a facilities contract. Profit or fee (plus or minus) shall be considered in awarding any related supply or service contract, consistent with the profit guidelines of Subpart 15.9.

(d) Special tooling and special test equipment will normally be provided to a contractor under a supply contract, but may be provided under a facilities contract when administratively desirable.

(e) Agencies shall ensure that facility projects involving real property transactions comply with applicable laws (e.g., 10 U.S.C. 2676 and 41 U.S.C. 12 and 14).

45.302-3 Other contracts.

(a) Facilities may be provided to a contractor under a contract other than a facilities contract when—

(1) The actual or estimated cumulative acquisition cost of the facilities provided by the contracting activity to the contractor at one plant or general location does not exceed $100,000;

(2) The contract is for construction;

(3) The contract is for services and the facilities are to be used in connection with the operation of a Government-owned plant or installation; or

(4) The contract is for work within an establishment or installation operated by the Government.

(b) When a facilities contract is not used, the Government's interest shall normally be protected by using the appropriate Government property clause or, in the case of (a)(3) above, by appropriate portions of the facilities clauses.

45.302-4 Contractor use of Government-owned and -operated test facilities.

(a) Agencies may authorize onsite use by contractors of existing Government-owned and -operated test facilities in connection with Government contracts only when—

(1) No adequate commercial test capability is available;

(2) Substantial cost savings will result from using the Government-owned test facilities; or

(3) Otherwise authorized by law.

(b) When such use is authorized, the contracting officer shall obtain adequate consideration comparable to commercial rates.

45.302-5 Standby or layaway requirements.

A facilities contract may include requirements for maintenance and storage of Government production and research property in standby or layaway status. The contract shall include appropriate specifications for the care and maintenance of the property. If the Government is required to pay the contractor for maintenance and storage, the contract shall define what constitutes standby or layaway and specify when payments will begin and end. The contract may provide for reimbursing the contractor for any State or local property tax it is required to pay because of its possession of or interest in such property (see 31.205-41).

45.302-6 Required Government property clauses for facilities contracts.

(a) The contracting officer shall insert the clause at 52.245-7, Government Property (Consolidated Facilities), in solicitations and contracts when a consolidated facilities contract is contemplated (see 45.301).

(b) The contracting officer shall insert the clause at 52.245-8, Liability for the Facilities, in solicitations and contracts when a consolidated facilities contract, a facilities acquisition contract, or a facilities use contract is contemplated (see 45.301).

(c) The contracting officer shall insert the clause at 52.245-9, Use and Charges, in solicitations and contracts (1) when a consolidated facilities contract or a facilities use contract (see 45.301) or (2) when a fixed-price contract is contemplated, and Government production and research property is provided other than on a rent-free basis.

(d) The contracting officer shall insert the clause at 52.245-10, Government Property (Facilities Acquisition), in solicitations and contracts when a facilities acquisition contract is contemplated (see 45.301).

(e) (1) The contracting officer shall insert the clause at 52.245-11, Government Property (Facilities Use), in solicitations and contracts when a facilities use contract is contemplated (see 45.301).

(2) If the contract is for the conduct of basic or applied research at nonprofit institutions of higher education, or is awarded to a nonprofit organization whose primary purpose is the conduct of scientific research (see 35.014), the contracting officer shall use the clause with its Alternate I.

45.302-7 Optional property-related clauses for facilities contracts.

(a) The contracting officer may insert the clause at 52.245-12, Contract Purpose (Nonprofit Educational Institutions), in solicitations and contracts when a facilities use contract is contemplated and award may be made to a nonprofit educational institution (also see 45.302-6).

(b) The contracting officer may insert the clause at 52.245-13, Accountable Facilities (Nonprofit Educational Institutions), in solicitations and contracts when a facilities contract is contemplated and award may be made to a nonprofit educational institution (also see 45.302-6).

(c) The contracting officer may insert the clause at 52.245-14, Use of Government Facilities, in solicitations and contracts when a facilities use contract is contemplated and award may be made to a nonprofit educational institution (also see 45.302-6).

OPTIONAL DISCUSSION QUESTIONS

1. (Q) The Volt Technical Corporation was awarded a contract to provide keypunch services and transfer data from cards to magnetic tape for personnel records. The Government provided the basic information on marked punch cards. Volt received $39,971.65 and seeks an equitable adjustment of $84,919.68 for the extra work because the cards were not in good order. Normally, the contractor might have expected a 1% rate in defective cards; instead, the rate was 13%. Volt claims it had the right to assume the cards would be in good condition for processing. The Government argued the condition of the cards was not considered in the contract. Should Volt be compensated for the extra work?

2. (Q) The Army Marching Division awarded a contract for 750770 stainless steel mess kits to Carrolton Mfg Co. for $860,839.80. The company agreed to rent certain Government furnished tooling or dies for $1,100 per month. The Government agreed to furnish the tooling in an "as is" condition. Carrollton used the tooling for 9 months and 11 days. It found the tooling in worse condition than anticipated when the contract was made. As a result, the company ran into excessive maintenance costs and down time. Now, the contractor claims that the Government should rebate $4,400 of the rent because of the defective tooling. If you were the ACO in this case, would you allow this claim?

3. (Q) Denmark & Morris, Inc. appealed to the ASBCA (Armed Services Board of Contract Appeals) after the ACO rejected its claim for $149,208.92. This claim represented a stated loss on an Army contract for the manufacture of 209,670 shelter halves. The cloth specified, to be furnished by the Government, was to be 33 inches in width. Some of the cloth which the Government furnished was less than 33 inches. Attempting to work the narrow cloth escalated contract costs. A thorough review of the situation by experts on both sides reduced the stated costs to $45,000. Should the ASBCA support the claim? Why?

4. (Q) The Army Marching Division awarded a contract to Daval Handbags, Inc. for the manufacturing of 377,380 duffel bags for $251,377.46. Daval had delivered 2,260 duffel bags, before a fire disabled its plant. The firm then subcontracted for the balance of the work. Under the terms of the contract, the Government was liable for furnishing material to Daval. So, the remaining material was shipped to the subcontractor. Unfortunately, the subcontractor converted some of the material for its own use. Daval was liable for the shortage. It amounted to 26,552 yards of 10-ounce

cotton duck and 36,618 yards of webbing. In determining the value of the shortage, the ACO used the Army Supply Catalog Pricing Guides, in effect at the time of the loss. Specifically, this was $1,50 per yard for the 10-ounce cotton duck and $0.36 per yard for the webbing. The total loss came to $53,010.48. Although Daval did not offer did not offer an alternative figure, it claimed this was excessive. The contractor charged the Army Supply Catalog Price was not a proper device for setting the price. The "Government Property" clause in the contract does not specify how a price is set, in event of loss. Do you think the ACO's figure will stick?

5. (Q) The Naval Clothing Supply Division (NAVCLOSUPD) awarded a contract to Martin Manufacturing Company, Inc. to manufacture and deliver 500,000 shirts at a total contract price of $337,500.00. The Standard Government Property clause was incorporated in the contract. The contract further provides for payment to the Government of $0.52 per yard of 36-inch wide cloth, for all yardage used in excess of the contract allowances. The Government would furnish all material needed for the contract. When the contract was completed, the Government had furnished 20,372.5 yards more than the contract allowance. Accordingly, the ACO applied the formula in the contract and stated the excess usage amounted to a total of $10,593.70. Of this amount $8,194.68 was withheld, leaving a balance due the Government of $2,399.02. The Martin Company objected to the figure. The contractor contended that over half of the cloth was defective and that excess usage actually amounted to much less than the Government figure. Do you think the ACO will be supported if the contractor appeal as the ACO's determination?

6. (Q) Allied Paint & Color Works, Inc. entered into a contract with the Navy to furnish 7,544 paint kits, to be delivered in various quantities, to a number of supply depots within 90 days after the date of the contract. The contract expressly provides the Government will furnish 1,911 gallons of type 11 phosphorescent paint. It is to be delivered to the contractor in one gallon cans within 30 days after the contract is signed. It also provided "the Contractor assumes the risk of, and shall be responsible for, any loss thereof or damage thereto, except for reasonable wear and tear, except to the extent to which the property is consumed in the performance of the contract." The parties called this agreement "Contract #1." Prior to the completion of this contract, 1,118 gallons of the original government-furnished paint were in Allied's inventory. The new contract did not have a contractor liability clause for

GFP. While the contractor was working on this contract, the premises caught fire and the 1,118 gallons of GFP paint valued at $6,898.06 was destroyed. There was no argument that the paint belonged to the Government. However, the contractor argued since the new paint-kit contract, the successor to the original contract, did not have the Contractor liability clause, Allied Paint should not have to compensate the Government for the Government issued by the ACO. On appeal, do you think the contractor will have to pay for the paint?

7. (Q) Generally, the FAR provides, that the Government will bear the risk of loss or damage to its property which has been furnished to contractors under either negotiated fixed-price or cost-type contracts. Under cost-type contracts, the Government takes title to contractor acquired property, as well as GFP, and acts as a selfinsurer. However, in fixed-price supply contracts the contractor must insure itself against loss of the government furnished property. In a report issued in 1984, the Comptroller General took violent exception to this policy on advertised fixed-price contracts. He stated: "In our review of insurance costs incurred by four major contractors during 5-year periods ended in 1981, we found that the Government incurred unnecessary costs of about $1,237,500 because the military services required contractors to bear the risk of loss or damage to certain Government owned parts, materials, inventories, work-in-process, and special tooling in their possession under fixed-price contracts." The Comptroller General recommended the Government become a self-insurer in all cases involving Government-furnished property regardless of the type of contractual instrument used. If your boss asked you to justify the DOD's present position, what arguments could you make?

NOTES

CHAPTER G

QUALITY ASSURANCE

We now direct our attention to the effectiveness of performance by the contractor. As important as it is for the contractor to receive payment for effort expended and deliverables, it is equally important to the Government to receive a product that works. The contractor must maintain an acceptable level of quality. The specific level of quality is dictated by the complexity, dollar value, and criticality of the product. Tailoring contract quality provisions and having a good QAR can be quite helpful in assuring all parties that the rights and duties of each are protected.

As a review, the following section is provided for your study.

	TOPIC	PAGE	ASSIGNMENT
1.	Handouts		
	a. Quality Assurance	G-2 thru G-16	Read
	b. Synopsis of higher-level Contract Quality Requirement	G-17	Read
	c. Synopsis Inspection Requirements/Rules	G-18 thru G-19	Read
	d. Delivery and Acceptance Synopsis	G-20 thru G-21	Read
2.	FARS Part 46.1 - 46.2	G-22 thru G-25	Read
3.	FAR Subsections 52.246-1,2,11,15,16,23, 24, 25	G-26 thru G-31	Read
4.	DFARS Part 46.1 & 46.2	G-32 thru G-35	Review

SCHOOL OF SYSTEMS AND LOGISTICS

ADVANCED CONTRACT ADMINISTRATION COURSE (PPM 304)

SUBJECT: Quality Assurance

TIME: 3.5 Hrs

OBJECTIVE: Comprehend Quality Assurance as a function of contract administration.

SAMPLES OF BEHAVIOR:

a. Describe the government and the contractors' responsibilities as relates to product quality.

b. Explain how contract quality requirements are determined and communicated to CAO.

c. Explain how the FAR QA responsibilities are performed by the CAO quality assurance function.

d. Identify barriers to communication between the CAO. Quality Assurance and Contract Management functions and possible methods of minimizing their occurrence.

e. Explain the differences in requirements and workload associated with the three commonly used quality clauses.

f. Describe types of specifications and problems of interpretation and compliance.

g. Identify techniques of QA which can be applied to contract administration.

h. Give examples of current issues and initiatives effecting quality management.

INSTRUCTIONAL METHODS: Lecture/Discussion
Case Analysis

STUDENT INSTRUCTIONAL MATERIALS ACA Textbook

REQUIRED STUDENT PREPARATION: As defined in Chapter "G" of the ACA textbook.

QUALITY ASSURANCE

It is basic government policy that the contractor is responsible for controlling the quality of the product which is offered to the government for acceptance. The government, however, recognizes its own responsibility for assuring that the product offered does in fact conform to contract requirements. The government's responsibility for quality assurance is carried out as surveillance of the contractor's quality control system or program.

In the field of contract administration, the significance of quality assurance cannot be overemphasized. Product acceptance the final act of quality assurance says in effect that the contractor has given us what we asked for in the contract. Excluding latent defects, gross mistakes amounting to fraud, fraud or warranty provisions, acceptance becomes binding upon the government. It is therefore imperative that the CAO team members become familiar with the language of this important functional area.

Definitions

Because of its importance, the CAO team members must become faimiliar with the language related to the area of quality assurance.

The following terms are used in acquisition quality assurance:

a. Complex item. An having quality characteristics, not wholly visible in the end item, for which contractual conformance must progressively be established through precise measurements, tests, and controls accomplished during purchasing, manufacturing, assembly, and functional operations either as an individual item or in conjunction with other items.

b. Corrective action. A series of actions available to the Quality Assurance Representative (QAR) for use with a contractor according to the seriousness of the nonconformance found. These actions require the contractor to correct conditions and assignable causes of nonconformance or defectiveness.

c. Critical application. A critical application of an item is one in which the failure of the item could injure personnel or jeopardize a military mission. Critical items may be either peculiar, having only one application, or common, having multiple applications.

d. Government Acquisition Quality Assurance (AQA). The Government function by which the government determines whether a contractor has fulfilled the contract obligations pertaining to quality and quantity. This function is related to and generally precedes the act of acceptance.

e. Material Review Board (MRB). The formal contractor government board established for the purpose of reviewing, evaluating, and disposing of specific nonconforming supplies or services, and for assuring the initiation and accomplishment of corrective action to preclude recurrence.

f. Noncomplex Item. An item having quality characteristics for which simple measurements and test of the end item is sufficient to determine conformance to contract requirements.

g. Procedure Evaluation. The continuing verification of the contractor's adherence to the written procedures and workbooks.

h. Procedures Review. The initial review of the contractor's written procedures and workbooks, including changes thereto to determine the adequacy of the procedures for the purpose intended.

i. Quality Assurance. A planned and systematic pattern of all actions necessary to provide adequate confidence that the item or product conforms to established technical requirements.

j. Quality Assurance Letters of Instructions and Special Inspection Requirements. Instructions issued by the Purchasing Office or its technical activities regarding the type and extent of government inspection pertaining to contracts for specific supplies or services that are complex or for which unusual requirements have been established.

k. Quality Assurance Representative (QAR). An organizational title assigned to the individual responsible for the government procurement quality assurance function at a given contractor's facility.

l. Request for Waiver. The formal document prepared by the contractor, or the subcontractors, and submitted by the prime contractor to the Government for the purpose of requesting acceptance of the designated nonconforming supplies or services, or for requesting temporary relief from a technical requirement of the contract.

m. Technical Activity. The government activity responsible for technical requirements such as specifications, drawings, and standards and prescribing inspection, testing, or other contract quality requirements that are essential to assure the integrity of products and services. It is normally the requiring activity.

n. Testing. An element of inspection which generally denotes the determination by technical means of properties or elements of supplies or components thereof, including functional operation; it involves the application of established scientific principles and procedures.

o. Test Report. A formal document describing the method of test and the results of a test.

p. Waiver. A written authorization to accept a configuration item or other designated items which, during production or after having been submitted for inspection, are found to depart from specified requirements, but nevertheless are considered suitable for "use as is" or after rework by an approved method. If the authorization is requested and granted prior to production, it is considered to be a deviation.

Contract Content Affecting Quality Assurance

The function of the CAO regarding quality on a given contract is governed in large part by the contract specifications and level of quality imposed by the contract.

Identify the different types and kinds of specifications.

A specification is a "document intended primarily for use in procurement, which clearly and accurately describes the essential and technical requirements for items, materials, or services, including the procedures by which it will be determined that the requirements have been met". Specifications for items and materials shall also contain preservation, packaging, packing and marking requirements.

While specifications cover the material requirements for an item, standards and other documents prepared for the procurement may establish other requisite characteristics.

It is not always possible to define the desired attributes or characteristics of an item with a written description. A drawing, on the other hand, can show physical relationships and dimensions with much greater precision. For this reason, drawings may be incorporated by reference in federal and military specifications, or they may be used as part of the purchase description.

Federal Specifications. Federal specifications cover materials, products, or services used, or expected to be used, by at least two federal agencies (at least one of which is civilian). The General Services Administration (GSA) supervises their preparation and issuance. With few exceptions, federal specifications are concerned with commercial type items.

Military Specifications. Military specifications cover materials, products or services used solely or predominantly by the military departments as opposed to civilian agencies. Coordinated Military Specifications cover items of interest to two or more departments, and are coordinated with all departments. Limited Coordination Military Specifications are prepared and issued by a single department. They satisfy an immediate procurement need of that department, or govern items that are of interest to it alone. If they are coordinated with all military departments, they become full military specifications.

Types of Item Specifications. Aside from the federal versus military classification, specifications are classified into a wide variety of types reflecting purpose, degree of detail, level of breakout, and so forth. For the purposes of this chapter, it should be adequate to consider the following three basic types as being the ones you are most likely to encounter.

Purchase Descriptions. The specifications identify the item by a brand name with the optional use off an "or equal" statement to allow competition. Such specifications are used to procure items on the commercial market and the regulations are quite strict in limiting their use. However, this type of specification, if properly used, can assist in obtaining competition in the purchase of standard articles.

Design Specifications. The specifications contain precise measurements, tolerances, materials, in-process and finished product tests, quality control and inspection requirements, and other detailed information. The information furnished is sufficiently detailed to insure that all items are manufactured to the specifications of detailed manufacturing drawing containing full information. The government uses such specifications to obtain standardization, interchangeability of spare parts, and complete uniformity of product even though different contractors manufacture the items. Under this type of program, the government warrrants that the specifications, if followed, will provide the item that the government desires. If the specification is defective, the government is liable for additional costs and schedule delays, if any.

Performance Specifications. The specifications contain performance characteristics desired for the item, with a statement perhaps that it must weigh no more than 20 pounds. In such specifications the specific configuration of the item, the detailed design, or exact measurements are not stated. These specifications are used extensively in development contracts, and are also frequently used in manufacturing contracts where competition is desired between different contractors' equipment which may vary in detail but which meet the general performance requirements of the government.

Under this type specification, the contractors creativity and design expertise are used to obtain an item that meets requirements without detailed "how to" information provided to the contractor. The risk of meeting performance parameters rests with the contractor.

The distinction between the types of specification is not as clear-cut as one might think. It becomes difficult to use a "purebred" specification type. The end product usually becomes an amalgam of several items into the final product. The fast pace of technology in today's world makes the use of a hybrid necessary for system support. The design life of a weapon system is usually much shorter than actual deployed life. Examples include battleships and B-52 bombers. Support for these systems

is extremely difficult to procure since data packages, if present, use antiquated technologies usually no longer available in the market place. In order to provide some sort of baseline to industry we may provide the "old" part as a model. Depending on the wording in the contract and general trade usage, we may have either a design, performance, or purchase description type specification.

Order of Precedence. Clear and accurate specifications are essential to effective procurement. To avoid confusion, the order of priority and the limitations of different documents should be clearly stated. They should establish, in the event of conflict, whether specifications have priority over drawings, the relation of general specifications to detailed specifications, and the applicability of other contract documents that describe the product. The following "Order of Precedence" clause, which may be modified to change the order or to add or delete items, is normally included in contracts.

ORDER OF PRECEDENCE

> In the event of an inconsistency between provisions of this solicitation, the inconsistency shall be resolved by giving precedence in the following order: (a) the Schedule (excluding the Specifications); (b) Terms and Conditions of the solicitation, if any; (c) General Provisions; (d) other provisions of the contract, when attached or incorporated by reference; and (e) the Specifications.
>
> (FAR 52.215-18)

As we have seen there are many reasons why specifications should be clear, accurate, easily understood, and not subject to misinterpretation. They describe what we need to buy, what the contractor must produce, and what we are willing to accept as satisfactory performance.

Inaccurate or incomplete descriptions of the work to be performed create general misunderstanding on the part of the firms solicited. More importantly, if not recognized and corrected, it may result in the procurement of an unsatisfactory product which could lead to operational failures of the equipment in the field. Even if detected in time and corrected by production changes, there may be delays and increased costs involved. Experience has shown that conflicting or ambiguous requirements are most likely to be interpreted against the government, since it supplied the specification. As a general rule, any ambiguity in a specification is the responsibility of the specification drafter.

Thus, it can be stated that the specification is probably the most important part of the contractual package. It behooves all of us then to give maximum attention to the adequacy of the specification, and to correct deficiencies as early in the procurement cycle as possible.

Describe the three levels of quality assurance requirements in the FAR and MIL-I-45208A and MIL-Q-9858A, and identify the criteria used to select the appropriate level for inclusion in the contract.

Normally, the technical activity or the buying activity is responsible for determining the level of quality effort required in the contract. The Federal Acquisition Regulation recognizes three levels of quality requirements. They are government reliance on inspection by the contractor, standard inspection requirements and higher level quality requirements. The DOD FAR supplement divides this last category into MIL-I-45208A, Inspection System and MIL-Q-9858A, the Quality Program.

Typically, a commercial, noncomplex, noncritical, off the shelf type item would not necessitate imposing a specific contract quality requirement. A complex, critical item designed to military drawings would be apt to require MIL-Q-9858A the highest quality requirement. Putting it another way, a contract for a major weapon system or subsystem would most likely contain a MIL-Q-9858A requirement Let's look at each of the quality requirement levels in a little more detail.

Government Reliance on Inspection by the Contractor. This is generally used for small purchases where there is no specific obligation for the performance of inspection, and where no government procurement quality assurance actions can be performed at source; such as imprest funds, or subscriptions.

Standard Inspection Provision. FAR Part 52.246 requires an inspection system acceptable to the government. No further definition is presented, but it does state that "the government has the right to inspect and test all supplies to the extent practicable at all places and times including the period of manufacture, and in any event before acceptance". This allows the Quality Assurance Representative (QAR) access to both the prime contractor's plant and also any subcontractor facilities that are considered necessary. The clause also provides that the contractor shall furnish and shall require subcontractors to furnish, without charge, all reasonable facilities and assistance for the safe and convenient performance of those duties. This doesn't mean a paneled office, but does mean that all test equipment necessary and safety equipment, if required, will be provided by the contractor.

This clause also allows the government to levy costs for reinspection when the contractor either does not have supplies available when he specified and, the government QAR was available or due to rejection of supplies, re-inspection is necessary. The government also has the right to require correction of nonconforming supplies.

This clause provides a very powerful tool that, when used properly, gives the government inspector the access and visibility necessary to convince the contractor that all specifications must be met or exceeded. This provision is

included in all contracts which exceed small purchase dollar limitations.

Higher Level Quality Requirements. These requirements include the MIL-I-45208A. Inspection System; and MIL-Q-9858A, The Quality Program.

MIL-I-45208A, Inspection System. This specification may be applied to the procurement of any supplies and services specified by the procuring agencies; however, it is normally used in the procurement of complex or critical items. When specified in the contract, it requires the contractor to establish an inspection system in accordance with the specification and to perform inspections and tests necessary to substantiate end item conformance to drawings, specifications, and contract requirements. In addition, records of each inspection are maintained which may be reviewed by the government. This system also includes the calibration requirements set forth in MIL STD 45662. (This requires the contractor to have positive control over inspection equipment and maintain a recall system depending on use and stability of each piece of equipment.)

The requirements of MIL-I-45208A are in addition to tests in other applicable specifications and contractual documents. It contains fewer requirements than MIL-Q-9858A; however, the contractor may use MIL-Q-9858A in whole or in part whenever MIL-I-45208A is specified, provided that no increase in price is involved. This permits a uniform system in the event the contractor is already required to comply with MIL-Q-9858A.

The inspection system established in compliance with this specification will be documented and available for review by the QAR prior to initiation of production, and throughout the life of the contract. The contractor must notify the QAR in writing of any change to the system. The system will be subject to disapproval if changes would result in nonconforming products.

MIL-Q-9858A, The Quality Program. This specification applies to complex supplies, equipment, and systems for which the requirements of MIL-I-45208A are inadequate to provide needed quality assurance. In such cases, total conformance to contract requirements cannot be obtained effectively and economically solely by controlling inspection and testing. Therefore, it is essential to control work operations and manufacturing processes as well as inspections and tests.

An effective and economical quality program, planned and developed in consonance with the contractor's other administrative and technical programs, is required by this specification. The program should assure adequate quality throughout all areas of contract performance, including design, development, fabrication, processing, assembly, inspection, test, maintenance, packaging, shipping, storage, and site installation.

All supplies and services under the contract, whether manufac-tured or performed within the contractor's plant or at any other source, must be controlled at all points necessary to assure conformance to contractual requirements. The program must

also provide for the prevention and ready detection of discrepancies, and for timely and positive corrective action. The contractor has to make objective evidence of quality conformance readily available to the QAR. Instructions and records for quality must be generated and maintained.

The authority and responsibility of those in charge of the design, production, testing, and inspection of quality must be clearly stated. The program should facilitate determinations of the effects of quality deficiencies and quality costs on price. Facilities and standards such as drawing, engineering changes, measuring equipment, and the like which are necessary for the required quality must be effectively managed. The program must also include an effective control of purchased materials and subcontracted work. Manufacturing, fabrications, and assembly work within the contractor's plant must be controlled completely. In addition, the contractor's quality program should include effective execution of responsibilities shared jointly with the government or related to government functions, such as control of government property and government source inspection. In subcontracts placed by the prime contractor, the quality requirements are also required.

In order to assure requisite quality, the specification requires the contractor to provide work instructions on all processes which could affect quality. The government QAR then uses the work instructions to verify that the system as approved is actually being used. If the QAR finds that the approved system is not being used, a Quality Deficiency Report will be issued to bring the system back into compliance. Prompt effective corrective action will keep the quality of the product within a manageable level.

Another aspect of this program is an element involving the "cost of quality". This cost data should include the cost of preventing and correcting defects. These data are useful to management of the company to uncover potential problem areas. Unlike most "reports" this data is not presented to the Government, but is "made available for on-site review". This provides reassurance to the QAR that management is involved in the quality process within the company.

Government Acquisition Quality Assurance

Government acquisition quality assurance is multifaceted. Procedures and responsibilities normally attributed to the QAR must be understood by the other members of the contract administration team.

The primary responsibility of the Quality Assurance Representative (QAR) is to assure that the product tendered to the Government for acceptance conforms to the contract requirements(s). The program for AQA is documented in DLAM 8200.1; which has been jointly coordinated by the services (Army-AR 702-4; Navy - NAVMATINST-4355.60A; USAF-AFR 74-15 and Marine Corp MCO-P-4855.4A). This document is NOT included in a contract. Five categories of effort which are carried out by plant level QARs are discussed below.

Concepts and Planning. The ultimate success of AQA is directly related to the planning effort that goes into it. Consequently, it is incumbent upon the responsible quality assurance personnel at plant level to review the contractual document upon receipt to determine the specific quality assurance action that will be required. The QAR's review and planning will consider, but not be limited to the level of quality contractually required, Quality Assurance Letters of Instruction (QALI) from the buying activity, government skills and manpower required, and contract clauses requiring special attention or staff assistance, such as:

- liquidated damages.
- government property.
- ground and flight risk.
- safety precaution for ammunition and explosives.
- AQA at subcontractor's plants.
- adequacy of the specifications and drawings.

Procedures Review. Having completed the review and planning, the QAR must next review the contractor's written quality procedures. Since the inspection and acceptance phase of quality assurance will not be initiated until acceptable procedures have been presented to the government, it is incumbent upon the QAR to advise the contractor of the acceptability or disapproval of those procedures as early in the production cycle as possible. Notice of acceptability MAY be given in writing; disapproval MUST be given in writing. If so specified in the contract, the CO may retain the right to approve the contractor's written procedures, in which case the QAR could forward comments to the CO for final approval/disapproval.

The QAR should use the following DOD Handbooks as guides for reviewing the contractor's written procedures. For MIL-Q-9858A use H-50 and for MIL-I-45208A use H-51.

Procedures Evaluation. Procedures evaluation is the activity involved in verifying that the contractor is complying with written quality procedures and that the procedures are accomplishing the intended purpose of controlling product quality.

Product Verification Inspection (PVI). The fourth element of Government Acquisition quality assurance is product verification inspection, which consists of two parts: initial product inspection and continuing verification.

Initial Product Inspection (IPI). The initial product inspection is performed during the earliest phase of production to verify the contractor's ability to control product quality. The basic assumption is that if a contractor can meet the contract specification requirements during the initial production, a high degree of probability exists that the requirements will continue to be met.

Continuing Verification. Continuing verification is performed throughout the life of the contract, and may be based on the requirements established by the CO in the contract or the quality assurance letter of instruction; verification inspection considered necessary by the QAR to establish assurance of contract compliance.

Corrective Action. Corrective action is the final and most significant step in the government acquisition quality assurance cycle. Corrective actions, properly effected, close the loop on the AQA process. It is the responsibility of the QAR to bring contract nonconformances to the attention of the contractor and to insure that the contractor takes the necessary action to correct the deficiencies and to eliminate the cause of those deficiencies. The QAR has five methods of corrective action available:

Method A. This is on-the-spot corrective action to correct minor defects and their causes. No follow-up is necessary.

Method B. When the defect is other than minor, the QAR will document the deficiency and forward it to appropriate contractor personnel for action. If the deficiencies might possibly have an impact on delivery for which the CAO has assigned production surveillance, a copy will be forwarded to the production element.

Method C. When serious quality problems exist or when the contractor has failed to respond satisfactorily to Method B, the QAR or a higher level government official will forward a letter to the contractor's top management requesting immediate action on the observed deficiencies and their causes. A copy of the action will normally be forwarded to the ACO and PCO.

Method D. When all else fails and severe discrepancies exist, the QAR will, though the supervisor, forward a letter to the ACO requesting the contractor be advised that all AQA actions will discontinue. The AQA program will be totally discontinued only when authorized by a letter signed by the ACO. Copies of this action will be forwarded to the PCO. This method puts the contractor on notice that goods or services tendered to the government will not be accepted.

Method E. This method is used at the subcontractor level when the corrective action required is of the magnitude of a Method C or D. The QAR cognizant over the prime contractor will be informed of the circumstances, and will be requested to have the prime contractor take necessary action with the subcontractor.

Describe the government policy on accepting nonconforming supplies/services.

Nonconforming Supplies. Although it is the general policy of DOD not to accept nonconforming supplies, there are established procedures for such acceptance when it is in the best interest of the Government. Final decisions regarding such acceptance are solely the prerogative of the government. Repeated offering of nonconforming supplies should be discouraged. Such an act of repeatedly offering nonconforming supplies generally indicates either a degradation in the contractor's control over product quality or a deficiency in contract technical requirements.

Authority. There are two types of nonconforming supplies/services. Type I nonconformances are major in nature, and affect one or more of the following areas:

- performance.
- durability.
- reliability.
- interchangeability.
- effective use or operation.
- weight or appearance where it is a factor.
- health or safety.
- form/fit/function of the item.

Type II nonconformances are minor in nature, and affect none of the areas listed under Type I. The right to accept Type I nonconforming supplies is generally reserved to the PCO. Acceptance of Type II nonconforming supplies is automatically vested in the ACO unless specifically withheld by the PCO.

Acceptance of nonconforming supplies may be accomplished either through a contractor-initiated request for waiver or through the action of a Material Review Board (MRB).

Request for Waiver. This is normally submitted to the PCO on Type I nonconformances, and to the ACO on a Type II nonconformance, where a corrective procedure has not been rejected by the material review board. The request for waiver is the prerogative of the contractor and must be processed the the QAR. Thought should be given to amending the contract to provide for equitable consideration to the government.

Material Review Board (MRB). This board is established to make decisions regarding the acceptance of Type II nonconformances. It is a joint contractor's quality control department, a qualified contractor engineer, and the QAR. This MRB determines disposition of the nonconforming material such as whether to accept, repair, rework, or scrap.

AQA at Subcontract Level. Government AQA at the subcontract level does not relieve the prime contractor of any responsibilities under the contract and does not establish any contractual relationship between the government and the

subcontractor. Further, AQA at the subcontract level is performed only for the benefit of the government and is never performed to assist a prime contractor in controlling his suppliers. The QAR at the prime contractor level is responsible for reviewing subcontracts to assure completeness and clarity of the quality requirements. It shall also be determined if conditions exist whereby AQA at subcontractor level is required, and shall request AQA assistance and provide direction to the CAO activity at the subcontractor location.

Describe the role of the contractor and government in inspection of supplies and services.

When a contract is awarded by the government, the contractor assumes responsibility for timely delivery and satisfactory performance. Failure to comply with specifications in a timely manner may be cause for default of the contract. Performance includes furnishing the government with the quantity and quality of items which the contractor has agreed to deliver and for which the government has agreed to pay. Although the contractor is fundamentally responsible, the government, through its contract administration activity, protects its interest to insure a quality product. This protection is afforded through inspections and requirements which are included in every contract.

The purpose of inspection is to determine whether the product or service conforms exactly to what the government has ordered. The extent of inspection varies with the dollar value of the contract and with the type of product. For example, a contract for "off-the-shelf" items under small purchase procedures may require minimum inspection after the items are received at their destination. Such inspection may be limited to counting the items under small purchase procedures may require minimum inspection after the items are received at their destination. Such inspection may be limited to counting the items, determining damage in transit, and verifying that the items are what was ordered. On the other hand, a contract for sophisticated aircraft or missile parts or assemblies will require a detailed inspection system which starts at the raw materials, continues through production, and ends with the completed item. Faulty inspection of one part during production could result in the acceptance of a poor quality end item, which in turn could cause aborted missions and loss of life.

There is no more official definition of inspection than that contained in FAR Part 46. "Inspection means the examination and testing of supplies or services (including when appropriate, raw material, components and intermediate assemblies) to determine whether they conform to contract requirement." The contract itself will contain the specifications or the description of the supplies or services, and when appropriate will also contain terms and conditions concerning inspection and control of quality requirements.

Determination of conformance of the product to the contract requirements shall be made on the basis of objective evidence of quality and quantity. The government inspector shall make optimum use of quality data generated by contractors in determining the acceptability of supplies. To the extent that contractor quality data are available and reliable, as determined by the government inspector, such data shall be used to adjust the amount of government inspection of products for acceptance purposes to a minimum consistent with proper assurance that the supplies accepted conform to the quality requirements established by the procurement documents.

Responsibility. The basic responsibility for inspection and quality is the contractors'. They are responsible for controlling product quality and for offering to the government for acceptance only those supplies and services that conform to contract requirements. The government's role is to determine how much it should inspect to insure the effectiveness of a contractor's procedure. That determination is usually made after considering the following factors:

a. Integrity and reliability of the contractor as a quality producer.

b. The adequacy of the contractor's inspection system which would include incoming material, lab testing, in-process inspection, packaging, packing, crating, and marking.

c. Previous government experience with the contractor.

d. The nature and value of the item involved.

Inspection of completed supplies is necessary to assure that contract requirements have been met. The responsibility of the contractor for inspection of completed supplies requires that the examinations and tests set forth in the specifications be completed. As the first step, the contractor will verify that all previous inspection operations have been performed. It is imperative at this stage that the contractor's inspections and tests performed will provide sufficient evidence to the government of complete compliance with contract requirements.

Remedies. The government may require correction of deficiencies, seek replacement by the contractor or others, terminate for default, or require delivery at a reduced price.

Contractor Protection. The contractor is protected in that the government may not unduly delay the work for inspection/test purposes. Further, delivery at reduced prices is subject to the disputes procedure.

Describe the act of acceptance and the rights of the government after acceptance.

Acceptance is the act of an authorized agent of the government by which the government agrees that the supplies or services submitted by a contractor conform to all requirements of the contract. This includes quality, quantity, and the condition of the supplies. The contract itself will include the time and place of acceptance. The acceptance procedure is important because, at that time, ownership transfers.

Transfer of Ownership. Ownership (titles) transfers to the government upon acceptance. The significance of this ownership transfer is that any damage or loss to the products involved is borne by the owner. Therefore, regardless of the point of inspection and time of delivery, government acceptance assumes title, ownership, and responsibility for the contract items.

Procedures for Acceptance. The Material Inspection and Receiving Report, DD Form 250, or other authorized form, is the document which accomplishes the formal acceptance of supplies or services on a Government contract. The government agent authorized to make acceptance signs the document which later serves as the authorization for payment to the contractor.

Implied Acceptance. After delivery is made, a reasonable period of time is allowed for government acceptance or rejection. Although the Government may not have formally accepted the items, acceptance may be implied by either the government's conduct or by the government's delay.

Delay. The contract inspection clause states, "...acceptance or rejection of supplies shall be made as promptly as practicable after delivery..." If items are rejected, it is important that a notice of rejection be furnished the contractor promptly. If timely notice is not furnished, acceptance may in certain cases be implied as a matter of law." The notice of rejection should be specific in defining the area of nonconformance discovered in inspection.

Actions. Although formal acceptance is not accomplished, specific actions by the government may be considered to imply acceptance. For example, if the government consumes part or all of defective items delivered, the acceptance of the consumed portion is generally considered to have been accomplished. Government alteration of items prior to rejection, or use of the items, generally constitute acceptance (implied).

Certificate of Conformance. Any discussion of inspection would not be complete without describing the certificate of conformance (COC). At the discretion of the Contracting Officer, a clause may be inserted in contracts requiring the contractor to certify that supplies or services comply with contract requirements. This clause may serve one of two purposes. It may be used as the sole basis for government acceptance and payment of contractor invoices without government inspection without prejudice to the government's right to inspect at a different

time or place. The certificate can also be used to obtain additional assurance that supplies conform to contract requirements prior to acceptance.

Contractor Responsibility after Acceptance. The government's acceptance is conclusive except for latent defects, fraud, or such gross mistakes as amount to fraud. Therefore, if any of these conditions are proved to exist, even after final payment is made, the contractor is still responsible. The remedies to the government are considered to be the same as those available when the items are found to be defective before acceptance. Also, damage to items in shipment may require correction by the contractor, even though the government owned the items at the time of shipment.

Latent Defects. A latent defect is a defect that existed at the time of government acceptance but could not be discovered by a reasonable inspection. Determination of "latent" then becomes a matter of what is reasonable. If the inspection is reasonable and the defect is not discovered, the defect is latent. If a reasonable examination of an article would reveal a defect, and the examination is not made, the defect is not latent, but a patent defect.

A reasonable inspection is one that would normally be performed as a custom of the trade. In the examination of shoes, for example, a visual inspection would suffice - an X-ray would not be expected; however, in the examination of welding done on structural steel, an X-ray inspection could be reasonably expected.

Fraud and Gross Mistakes. The contractor is responsible during the life of the product for any defects found because of fraud or gross mistakes. To obtain relief for a defective item, the government must prove fraud, which means it is necessary to show intent to deceive by the contractor in that it misrepresented a material fact and then the government relied upon the misrepresentation. To establish a gross mistake that amounts to fraud, it is necessary to prove that the error was so gross that it should be considered as fraud; however, it is not necessary to prove intent to deceive. It is very difficult to prove intent, thus proof of fraud is not often achieved.

HIGHER-LEVEL

Contract Quality Requirements

MIL-I-45208A

- Requires establishment of an inspection system
- Documentation, Records, and Corrective Action
    - Insp/Test Documentation - Procedural instruction(s) pass/fall criteria
    - Records - Inspection(s) performed, deficiencies found and corrective action
- MIL-STD-45662A - Calibration of test equipment
- Inspection status - tag system
- Procedures for GFM
- Non-conforming material
- Sub contractor issues

MIL-Q-9858A

- Everything in MIL-I-45208A, plus the following:
    - Requires establishment of a quality program
    - The function(s) responsible for quality must have sufficient organizational freedom to identify and have quality problems corrected
    - Costs of quality - and of unquality
    - Process controls
    - Statistical QC and analysis

Standard Inspection Clause

"The FAR directions on use of the Standard Inspection Clauses in supply contracts are stated in FAR 46.302 and 46.303 (text page G-25). The appropriate Standard Inspection Clause shall also be specifically included in a contract whenever a higher-level contract quality requirement (MIL-I-45208A or MIL-Q-9858A) is included in the contract. However, MIL-I-45208A does not have to be specifically included into a contract that contains MIL-Q-9858A; MIL-I-45208A is incorporated into MIL-Q-9858A."

INSPECTION

I. "STANDARD INSPECTION CLAUSE (FFP SUPPLY CONTRACT)" ESTABLISHES RIGHT TO INSPECT

A. To the extent practicable at all times and places.

1. During period of manufacture.

2. Prior to shipment.

3. At destination.

B. Contractor, without additional charge, must provide facilities for inspection.

1. Reasonable facilities.

2. Safety and convenience of inspectors.

C. Where inspection is not on premises of contractor or subcontractor, it is at the expense of the Government.

D. Government representatives must not unduly delay work of the contractor.

E. Can charge contractor costs of re-inspection when supplies are not ready for inspection at prescribed time.

II. "STANDARD INSPECTION CLAUSE (FFP SUPPLY CONTRACT)" PROVIDES RIGHT TO REJECT OR TO REQUIRE CORRECTION

A. Contractor must disclose identify of corrected items.

B. Inspection does not relieve contractor of responsibility for defects if discovered before acceptance.

III. "STANDARD INSPECTION CLAUSE (FFP SUPPLY CONTRACT)" PROVIDES FOR FAILURE TO CORRECT DEFECTS

A. Government may replace or correct and charge costs to contractor.

B. Default termination (usually last resort type of action)

C. Price reduction (subject to disputes clause) if failure to deliver within schedule.

IV. "STANDARD INSPECTION CLAUSE (FFP SUPPLY CONTRACT)" REQUIRES THE CONTRACTOR TO MAINTAIN AN INSPECTION SYSTEM ACCEPTABLE TO GOVERNMENT.

A. Records maintained and available to Government.

B. Other provisions of contract may expand contractor responsibility.

V. COMPARISON OF OTHER STANDARD INSPECTION CLAUSES

A. Construction contracts. Government inspection and test of materials and workmanship are made at the work site. Before acceptanc the Government can require the removal or tear-out of the completed work. If work is acceptable, Government compensates contractor for inspection time and rework.

B. Cost reimbursement contracts. The Government may require contractor correction or replacement of supplies at any time up to six (6) months after acceptance if defective at the time of delivery. Contractor's cost will be paid by the Government but no fee will be paid.

C. R & D fixed-price contracts. If the contractor fails to correct defective work, the Government may accept such work at an equitable reduction in price.

VI. GENERAL RULES

A. Inspection does not constitute acceptance.

B. Inspection at contractor's plant does not preclude inspection prior to acceptance.

C. Inspection does not constitute a waiver of defective materials and workmanship.

D. Failure of the Government to inspect does not relieve the contractor of his obligations to comply with plans and specifications.

E. If tolerances not specified in the contract, an unreasonable interpretation by the inspector may constitute constructive change (contracting officer should determine).

F. A superabundance of shop drawings of details may constitute a constructive change if required by inspector or contracting officer.

G. Inspection by Government does not shift responsibility for product quality away from the contractor.

H. Acceptance will generally constitute a waiver of specifications unless it is conditional.

1. **WHEN ACCEPTANCE TAKES PLACE**

   a. Inspection of supplies not essential (small purchases).

   b. Point of acceptance.

      (1) Contract terms control.

         (a) At contractor's facility.

         (b) At designation.

      (2) Reasonable period of time allowed after delivery.

         (a) Implied acceptance possible after reasonable time.

         (b) Failure to notify of rejection may constitute acceptance.

2. **OWNERSHIP TRANSFERS TO GOVERNMENT UPON ACCEPTANCE**

   a. Responsibility for supplies changes with acceptance.

   b. Contractor responsibility can continue after acceptance, if contract provides.

   c. Place of delivery and acceptance can be modified by use of changes article.

3. **PROCEDURE REQUIRED PRIOR TO ACCEPTANCE**

   a. DD Form 250, Material Inspection and Receiving Report, is the document which accomplishes the formal acceptance of supplies or services on a Government contract.

   b. Delivery (GBL or CBL), Bill of Lading serves as (1) a receipt for goods received by a carrier for transportation; (2) a contract of carriage; (3) documentary evidence of title to the goods in case of dispute; (4) the document by which a carrier is paid for transportation service rendered to the Government.

4. **CONTRACTOR RESPONSIBILITY AFTER ACCEPTANCE**

   a. Latent defects -- responsibility continues.

   b. Fraud or gross mistake -- responsibility continues.

   c. Supplies damaged in shipment on GBL.

      (1) Faulty packaging can cause contractor liability.

(2) Negligence of contractor in loading supplies can cause contractor liability.

(3) Damage by striking workers of contractor after acceptance not ordinarily contractor responsibility.

d. Insurance covering loss.

(1) Government is self-insurer.

(2) Contractor should protect himself against liability.

5. RESPONSIBILITY OF CARRIERS

a. Negligence -- carrier generally liable for his own negligence.

b. Acts of God -- carrier generally not liable.

6. GENERAL RULES

a. Government is obligated to accept items which meet specifications, including package and delivery requirements, but is not obligated to accept early delivery.

b. Minor deviations from specifications where the Government is not damaged, but receives a superior product should be accepted without price adjustment.

c. Acceptance generally acts as a waiver of deviations which are patent.

d. An equitable adjustment in contract price should be negotiated prior to acceptance of goods where there has been a late delivery or minor detrimental deviation from specification.

e. Acceptance transfers title to the supplies to the Government and responsibility for loss or damage transfers to the Government.

f. Improper rejections of goods in lieu of acceptance can result in additional cost to the Government.

g. Rejection and notification changes the responsibility of the Government for negligence in the care and handling of supplies.

PART 46

QUALITY ASSURANCE

46.000 Scope of part.

This part prescribes policies and procedures to ensure that supplies and services acquired under Government contract conform to the contract's quality and quantity requirements. Included are inspection, acceptance, warranty, and other measures associated with quality requirements.

SUBPART 46.1—GENERAL

46.101 Definitions.

"Acceptance," as used in this part, means the act of an authorized representative of the Government by which the Government, for itself or as agent of another, assumes ownership of existing identified supplies tendered or approves specific services rendered as partial or complete performance of the contract.

"Contract quality requirements," means the technical requirements in the contract relating to the quality of the product or service and those contract clauses prescribing inspection, and other quality controls incumbent on the contractor, to assure that the product or service conforms to the contractual requirements.

"Government contract quality assurance," means the various functions, including inspection, performed by the Government to determine whether a contractor has fulfilled the contract obligations pertaining to quality and quantity.

"Inspection," means examining and testing supplies or services (including, when appropriate, raw materials, components, and intermediate assemblies) to determine whether they conform to contract requirements.

"Off-the-shelf item," means an item produced and placed in stock by a contractor, or stocked by a distributor, before receiving orders or contracts for its sale. The item may be commercial or produced to military or Federal specifications or description.

"Subcontractor" (see 44.101).

"Testing," means that element of inspection that determines the properties or elements, including functional operation of supplies or their components, by the application of established scientific principles and procedures.

46.102 Policy.

Agencies shall ensure that—

(a) Contracts include inspection and other quality requirements, including warranty clauses when appropriate, that are determined necessary to protect the Government's interest.

(b) Supplies or services tendered by contractors meet contract requirements;

(c) Government contract quality assurance is conducted before acceptance (except as otherwise provided in this part), by or under the direction of Government personnel;

(d) No contract precludes the Government from performing inspection;

(e) Nonconforming supplies or services are rejected, except as otherwise provided in 46.407; and

(f) The quality assurance and acceptance services of other agencies are used when this will be effective, economical, or otherwise in the Government's interest (see Subpart 42.1.)

46.103 Contracting office responsibilities.

Contracting offices are responsible for—

(a) Receiving from the activity responsible for technical requirements any specifications for inspection, testing, and other contract quality requirements essential to ensure the integrity of the supplies or services (the activity responsible for technical requirements is responsible for prescribing such inspection, testing, and other contract quality requirements);

(b) Including in solicitations and contracts the appropriate requirements for the contractor's control of quality for the supplies or services to be acquired;

(c) Issuing any necessary instructions to the cognizant contract administration office and acting on recommendations submitted by that office (see 42.301 and 46.104(f); and

(d) When contract administration is retained (see 42.203), verifying that the contractor fulfills the contract quality requirements.

46.104 Contract administration office responsibilities.

When a contract is assigned for administration to the contract administration office cognizant of the contractor's plant, that office, unless specified otherwise, shall—

(a) Develop and apply efficient procedures for performing Government contract quality assurance actions under the contract in accordance with the written direction of the contracting office:

(b) Perform all actions necessary to verify whether the supplies or services conform to contract quality requirements;

(c) Maintain, as part of the performance records of the contract, suitable records reflecting—

(1) The nature of Government contract quality assurance actions, including, when appropriate, the number of observations made and the number and type of defects; and

(2) Decisions regarding the acceptability of the products, the processes, and the requirements, as well as action to correct defects.

(d) Implement any specific written instructions from the contracting office;

(e) Report to the contracting office any defects observed in design or technical requirements, including contract quality requirements; and

(f) Recommend any changes necessary to the contract, specifications, instructions, or other requirements that will provide more effective operations or eliminate unnecessary costs (see 42.102(e) and 46.103(c)).

46.105 Contractor responsibilities.

(a) The contractor is responsible for carrying out its obligations under the contract by—

(1) Controlling the quality of supplies or services;

(2) Tendering to the Government for acceptance only those supplies or services that conform to contract requirements;

(3) Ensuring that vendors or suppliers of raw materials, parts, components, subassemblies, etc., have an acceptance quality control system; and

(4) Maintaining substantiating evidence, when required by the contract, that the supplies or services conform to contract quality requirements, and furnishing such information to the Government as required.

(b) The contractor may be required to provide and maintain an inspection system or program for the control of quality that is acceptable to the Government (see 46.202).

(c) The control of quality by the contractor may relate to, but is not limited to—

(1) Manufacturing processes, to ensure that the product is produced to, and meets, the contract's technical requirements;

(2) Drawings, specifications, and engineering changes, to ensure that manufacturing methods and operations meet the contract's technical requirements;

(3) Testing and examination, to ensure that practices and equipment provide the means for optimum evaluation of the characteristics subject to inspection;

(4) Reliability and maintainability assessment (life, endurance, and continued readiness);

(5) Fabrication and delivery of products, to ensure that only conforming products are tendered to the Government;

(6) Technical documentation, including drawings, specifications, handbooks, manuals, and other technical publications;

(7) Preservation, packaging, packing, and marking; and

(8) Procedures and processes for services to ensure that services meet contract performance requirements.

(d) The contractor is responsible for performing all inspections and test required by the contract except those specifically reserved for performance by the Government (see 46.201(c).

SUBPART 46.2—CONTRACT QUALITY REQUIREMENTS

46.201 General.

(a) The contracting officer shall include in the solicitation and contract the appropriate quality requirements. The type and extent of contract quality requirements needed depends on the particular acquisition and may range from inspection at time of acceptance to a requirement for the contractor's implementation of a comprehensive program for controlling quality.

(b) As feasible, solicitations and contracts may provide for alternative, but substantially equivalent, inspection methods to obtain wide competition and low cost. The contracting officer may also authorize contractor-recommended alternatives when in the Government's interest and approved by the activity responsible for technical requirements.

(c) Although contracts generally make contractors responsible for performing inspection before tendering supplies to the Government, there are situations in which contracts will provide for specialized inspections to be performed solely by the Government. Among situations of this kind are—

(1) Tests that require use of specialized test equipment or facilities not ordinarily available in suppliers' plants or commercial laboratories (e.g., ballistic testing of ammunition, unusual environmental tests, and simulated service tests); and

(2) Contracts that require Government testing for first article approval (see Subpart 9.3).

(d) Except as otherwise specified by the contract, required contractor testing may be performed in the contractor's or subcontractor's laboratory or testing facility, or in any other laboratory or testing facility acceptable to the Government.

46.202 Types of contract quality requirements.

Contract quality requirements fall into three general categories, depending on the extent of quality assurance needed by the Government for the acquisition involved.

46.202-1 Government reliance on inspection by contractor.

(a) Except as specified in (b) below, the Government shall rely on the contractor to accomplish all inspection and testing needed to ensure that supplies or services acquired under small purchases conform to contract quality requirements before they are tendered to the Government (see 46.301).

(b) The Government shall not rely on inspection by the contractor if the contracting officer determines that the Government has a need to test the supplies or services in advance of their tender for acceptance, or to pass judgment upon the adequacy of the contractor's internal work processes. In making the determination, the contracting officer shall consider—

(1) The nature of the supplies and services being purchased and their intended use (see 46.204 and Table 46-1);

(2) The potential losses in the event of defects;

(3) The likelihood of uncontested replacement or correction of defective work; and

(4) The cost of detailed Government inspection.

46.202-2 Standard inspection requirements.

(a) Standard inspection requirements are contained in the clauses prescribed in 46.302 through 46.308, and 46.310, and in the product and service specifications that are included in solicitations and contracts.

(b) The clauses referred to in (a) above—

(1) Require the contractor to provide and maintain an inspection system that is acceptable to the Government;

(2) Give the Government the right to make inspections and tests while work is in process; and

(3) Require the contractor to keep complete, and make available to the Government, records of its inspection work.

46.202-3 Higher-level contract quality requirements.

(a) Higher-level contract quality requirements are contained in the clause prescribed in 46.311. Such requirements are appropriate in solicitations and contracts for complex and critical items (see 46.203(b) and (c)) or when the technical requirements of the contract are such as to require—

(1) Control of such things as work operations, in-process controls, and inspection (see 46.204 and Table 46-1); or

(2) Attention to such factors as organization, planning, work instructions, documentation control, and advanced metrology.

(b) If it is in the Government's interest to require that higher-level contract quality requirements be maintained, the contract shall require the contractor to comply with a Government-specified inspection system, quality control system, or quality program (e.g., MIL-I-45208, MIL-Q-9858, NHB 5300.4(1B), NHB 5300.4(1C), FED-STD-368, or ANSI/ASME NQA-1). The contracting officer shall consult technical personnel before including one of these specifications in a contract.

46.203 Criteria for use of contract quality requirements.

The extent of contract quality requirements, including contractor inspection, required under a contract shall usually be based upon the classification of the contract item (supply or service) as determined by its technical description, its complexity, and the criticality of its application.

(a) *Technical description.* Contract items may be technically classified as—

(1) Commercial (described in commercial catalogs, drawings, or industrial standards);

(2) Military-Federal (described in Government drawings and specifications); or

(3) Off-the-shelf (see 46.101).

(b) *Complexity.* (1) Complex items have quality characteristics, not wholly visible in the end item, for which contractual conformance must be established progressively through precise measurements, tests, and controls applied during purchasing, manufacturing, performance, assembly, and functional operation either as an individual item or in conjunction with other items.

(2) Noncomplex items have quality characteristics for which simple measurement and test of the end item are sufficient to determine conformance to contract requirements.

(c) *Criticality.* (1) A critical application of an item is one in which the failure of the item could injure personnel or jeopardize a vital agency mission. A critical item may be either peculiar, meaning it has only one application, or common, meaning it has multiple applications.

(2) A noncritical application is any other application. Noncritical items may also be either peculiar or common.

46.204 Application of criteria.

Subject to mandatory limitations contained in the clause prescriptions (see Subpart 46.3), Table 46-1 may be used as a guide in selecting the appropriate contract quality requirements. Where circumstances warrant, the contracting officer may specify a requirement different from that arrived at through use of the table, except for off-the-shelf items.

TABLE 46-1 CONTRACT QUALITY REQUIREMENTS GUIDE

Item		Type of Contract	
Technical Description	Complexity	Application	Quality Requirement
Commercial	Noncomplex	Noncritical Common	Contractor inspection (46.202-1)
Commercial	Noncomplex	Noncritical Peculiar	Contractor inspection (46.202-1)

TABLE 46-1 CONTRACT QUALITY REQUIREMENTS GUIDE—Continued

Item		Type of Contract	
Technical Description	Complexity	Application	Quality Requirement
Commercial	Noncomplex	Critical	Standard inspection (46.202-2)
Commercial	Complex	Noncritical Common	Contractor inspection (46.202-1)
Commercial	Complex	Noncritical Peculiar	Standard inspection (46.202-2)
Commercial	Complex	Critical	Higher-level (46.202-3)
Military-Federal	Noncomplex	Noncritical Common	Standard inspection (46.202-2)
Military-Federal	Noncomplex	Noncritical Peculiar	Standard inspection (46.202-2)
Military-Federal	Noncomplex	Critical	Higher-level (46.202-3)
Military-Federal	Complex	Noncritical Common	Standard inspection (46.202-2)
Military-Federal	Complex	Noncritical Peculiar	Higher-level (46.202-3)
Military-Federal	Complex	Critical	Higher-level (46.202-3)
Off-the-shelf	All	Noncritical	Contractor inspection (46.202-1)
Off-the-shelf	All	Critical	Standard inspection (46.202-2)

SUBPART 46.3—CONTRACT CLAUSES

46.301 Contractor inspection requirements.

The contracting officer shall insert the clause at 52.246-1, Contractor Inspection Requirements, in solicitations and contracts for supplies or services when the contract amount is expected to be within the small purchase limitation and (a) inclusion of the clause is necessary to ensure an explicit understanding of the contractor's inspection responsibilities, or (b) inclusion of the clause is required under agency procedures. The clause shall not be used if the contracting officer has made the determination specified in 46.202-1(b).

46.302 Fixed-price supply contracts.

The contracting officer shall insert the clause at 52.246-2, Inspection of Supplies—Fixed-Price, in solicitations and contracts for supplies, or services that involve the furnishing of supplies, when a fixed-price contract is contemplated and the contract amount is expected to exceed the small purchase limitation. The contracting officer may insert the clause in such solicitations and contracts when the contract amount is expected to be within the small purchase limitation and inclusion of the clause is in the Government's interest. If a fixed-price incentive contract is contemplated, the contracting officer shall use the clause with its Alternate I. If a fixed-ceiling-price contract with retroactive price redetermination is contemplated, the contracting officer shall use the clause with its Alternate II.

46.303 Cost-reimbursement supply contracts.

The contracting officer shall insert the clause at 52.246-3, Inspection of Supplies—Cost-Reimbursement, in solicitations and contracts for supplies, or services that involve the furnishing of supplies, when a cost-reimbursement contract is contemplated.

46.304 Fixed-price service contracts.

The contracting officer shall insert the clause at 52.246-4, Inspection of Services—Fixed-Price, in solicitations and contracts for services, or supplies that involve the furnishing of services, when a fixed-price contract is contemplated and the contract amount is expected to exceed the small purchase limitation. The contracting officer may insert the clause in such solicitations and contracts when the contract amount is expected to be within the small purchase limitation and inclusion is in the Government's interest.

46.305 Cost-reimbursement service contracts.

The contracting officer shall insert the clause at 52.246-5, Inspection of Services—Cost Reimbursement, in solicitations and contracts for services, or supplies that involve the furnishing of services, when a cost-reimbursement contract is contemplated.

46.306 Time-and-material and labor-hour contracts.

The contracting officer shall insert the clause at 52.246-6, Inspection—Time-and-Material and Labor-Hour, in solicitations and contracts when a time-and-material contract or a labor-hour contract is contemplated. If Government inspection and acceptance are to be performed at the contractor's plant, the contracting officer shall use the clause with its Alternate I.

46.307 Fixed-price research and development contracts.

(a) The contracting officer shall insert the clause at 52.246-7, Inspection of Research and Development—Fixed-Price, in solicitations and contracts for research and development when (1) the primary objective of the contract is the delivery of end items other than designs,

52.246-1 Contractor Inspection Requirements.

As prescribed in 46.301, insert the following clause in solicitations and contracts for supplies or services when the contract amount is expected to be within the small purchase limitation and (a) inclusion of the clause is necessary to ensure an explicit understanding of the contractor's inspection responsibilities, or (b) inclusion of the clause is required under agency procedures. The clause shall not be used if the contracting officer has made the determination specified in 46.202-1(b).

CONTRACTOR INSPECTION REQUIREMENTS
(APR 1984)

The Contractor is responsible for performing or having performed all inspections and tests necessary to substantiate that the supplies or services furnished under this contract conform to contract requirements, including any applicable technical requirements for specified manufacturers' parts. This clause takes precedence over any Government inspection and testing required in the contract's specifications, except for specialized inspections or tests specified to be performed solely by the Government.

(End of clause)
(R 7-103.24 1968 SEP)

52.246-2 Inspection of Supplies—Fixed-Price.

As prescribed in 46.302, insert the following clause:

INSPECTION OF SUPPLIES—FIXED-PRICE
(JUL 1985)

(a) Definition. "Supplies," as used in this clause, includes but is not limited to raw materials, components, intermediate assemblies, end products, and lots of supplies.

(b) The Contractor shall provide and maintain an inspection system acceptable to the Government covering supplies under this contract and shall tender to the Government for acceptance only supplies that have been inspected in accordance with the inspection system and have been found by the Contractor to be in conformity with contract requirements. As part of the system, the Contractor shall prepare records evidencing all inspections made under the system and the outcome. These records shall be kept complete and made available to the Government during contract performance and for as long afterwards as the contract requires. The Government may perform reviews and evaluations as reasonably necessary to ascertain compliance with this paragraph. These reviews and evaluations shall be conducted in a manner that will not unduly delay the contract work. The right of review, whether exercised or not, does not relieve the Contractor of the obligations under the contract.

(c) The Government has the right to inspect and test all supplies called for by the contract, to the extent practicable, at all places and times, including the period of manufacture, and in any event before acceptance. The Government shall perform inspections and tests in a manner that will not unduly delay the work. The Government assumes no contractual obligation to perform any inspection and test for the benefit of the Contractor unless specifically set forth elsewhere in this contract.

(d) If the Government performs inspection or test on the premises of the Contractor or a subcontractor, the Contractor shall furnish, and shall require subcontractors to furnish, without additional charge, all reasonable facilities and assistance for the safe and convenient performance of these duties. Except as otherwise provided in the contract, the Government shall bear the expense of Government inspections or tests made at other than the Contractor's or subcontractor's premises; *provided*, that in case of rejection, the Government shall not be liable for any reduction in the value of inspection or test samples.

(e) (1) When supplies are not ready at the time specified by the Contractor for inspection or test, the Contracting Officer may charge to the Contractor the additional cost of inspection or test.

(2) The Contracting Officer may also charge the Contractor for any additional cost of inspection or test when prior rejection makes reinspection or retest necessary.

(f) The Government has the right either to reject or to require correction of nonconforming supplies. Supplies are nonconforming when they are defective in material or workmanship or are otherwise not in conformity with contract requirements. The Government may reject nonconforming supplies with or without disposition instructions.

(g) The Contractor shall remove supplies rejected or required to be corrected. However, the Contracting Officer may require or permit correction in place,

promptly after notice, by and at the expense of the Contractor. The Contractor shall not tender for acceptance corrected or rejected supplies without disclosing the former rejection or requirement for correction, and, when required, shall disclose the corrective action taken.

(h) If the Contractor fails to promptly remove, replace, or correct rejected supplies that are required to be removed or to be replaced or corrected, the Government may either (1) by contract or otherwise, remove, replace, or correct the supplies and charge the cost to the Contractor or (2) terminate the contract for default. Unless the Contractor corrects or replaces the supplies within the delivery schedule, the Contracting Officer may require their delivery and make an equitable price reduction. Failure to agree to a price reduction shall be a dispute.

(i) (1) If this contract provides for the performance of Government quality assurance at source, and if requested by the Government, the Contractor shall furnish advance notification of the time (i) when Contractor inspection or tests will be performed in accordance with the terms and conditions of the contract and (ii) when the supplies will be ready for Government inspection.

(2) The Government request shall specify the period and method of the advance notification and the Government representative to whom it shall be furnished. Requests shall not require more than 2 workdays of advance notification if the Government representative is in residence in the Contractor's plant, nor more than 7 workdays in other instances.

(j) The Government shall accept or reject supplies as promptly as practicable after delivery, unless otherwise provided in the contract. Government failure to inspect and accept or reject the supplies shall not relieve the Contractor from responsibility, nor impose liability on the Government, for nonconforming supplies.

(k) Inspections and tests by the Government do not relieve the Contractor of responsibility for defects or other failures to meet contract requirements discovered before acceptance. Acceptance shall be conclusive, except for latent defects, fraud, gross mistakes amounting to fraud, or as otherwise provided in the contract.

(l) If acceptance is not conclusive for any of the reasons in paragraph (k) hereof, the Government, in addition to any other rights and remedies provided by law, or under other provisions of this contract, shall have the right to require the Contractor (1) at no increase in contract price, to correct or replace the defective or nonconforming supplies at the original point of delivery or at the Contractor's plant at the Contracting Officer's election, and in accordance with a reasonable delivery schedule as may be agreed upon between the Contractor and the Contracting Officer; *provided*, that the Contracting Officer may require a reduction in contract price if the Contractor fails to meet such delivery schedule, or (2) within a reasonable time after receipt by the Contractor of notice of defects or nonconformance, to repay such portion of the contract as is equitable under the circumstances if the Contracting Officer elects not to require correction or replacement. When supplies are returned to the Contractor, the Contractor shall bear the transportation cost from the original point of delivery to the Contractor's plant and return to the original point when that point is not the Contractor's plant. If the Contractor fails to perform or act as required in (1) or (2) above and does not cure such failure within a period of 10 days (or such longer period as the Contracting Officer may authorize in writing) after receipt of notice from the Contracting Officer specifying such failure, the Government shall have the right by contract or otherwise to replace or correct such supplies and charge to the Contractor the cost occasioned the Government thereby.

(End of clause)

Alternate I (JUL 1985). If a fixed-price incentive contract is contemplated, substitute paragraphs (g), (h), and (l) below for paragraphs (g), (h), and (l) of the basic clause.

(g) The Contractor shall remove supplies rejected or required to be corrected. However, the Contracting Officer may require or permit correction in place, promptly after notice. The Contractor shall not tender for acceptance corrected or rejected supplies without disclosing the former rejection or requirement for correction, and when required shall disclose the corrective action taken. Cost of removal, replacement, or correction shall be considered a cost incurred, or to be incurred, in the total final negotiated cost fixed under the incentive price revision clause. However, replacements or corrections by the Contractor after the establishment of the total final price shall be at no increase in the total final price.

(h) If the Contractor fails to promptly remove, replace, or correct rejected supplies that are required to be removed or to be replaced or corrected, the Government may either (1) by contract or otherwise, remove, replace, or correct the supplies and equitably reduce the target price or, if established, the total final price or (2) may terminate the contract for default. Unless the Contractor corrects or replaces the nonconforming supplies within the delivery schedule, the Contracting Officer may require their delivery and equitably reduce any target price or, if it is established, the

total final contract price. Failure to agree upon an equitable price reduction shall be a dispute.

(l) If acceptance is not conclusive for any of the reasons in paragraph (k) hereof, the Government, in addition to any other rights and remedies provided by law, or under other provisions of this contract, shall have the right to require the Contractor (1) at no increase in any target price or, if it is established, the total final price of this contract, to correct or replace the defective or nonconforming supplies at the original point of delivery or at the Contractor's plant at the Contracting Officer's election, and in accordance with a reasonable delivery schedule as may be agreed upon between the Contractor and the Contracting Officer; *provided*, that the Contracting Officer may require a reduction in any target price, or, if it is established, the total final price of this contract, if the Contractor fails to meet such delivery schedule; or (2) within a reasonable time after receipt by the Contractor of notice of defects or nonconformance, to repay such portion of the total final price as is equitable under the circumstances if the Contracting Officer elects not to require correction or replacement. When supplies are returned to the Contractor, the Contractor shall bear the transportation costs from the original point of delivery to the Contractor's plant and return to the original point when that point is not the Contractor's plant. If the Contractor fails to perform or act as required in (1) or (2) above and does not cure such failure within a period of 10 days (or such longer period as the Contracting Officer may authorize in writing) after receipt of notice from the Contracting Officer specifying such failure, the Government shall have the right by contract or otherwise to replace or correct such supplies and equitably reduce any target price or, if it is established, the total final price of this contract.

Alternate II (JUL. 1985). If a fixed-ceiling-price contract with retroactive price redetermination is contemplated, substitute paragraphs (g), (h), and (l) below for paragraphs (g), (h), and (l) of the basic clause:

(g) The Contractor shall remove supplies rejected or required to be corrected. However, the Contracting Officer may require or permit correction in place, promptly after notice. The Contractor shall not tender for acceptance corrected or rejected supplies without disclosing the former rejection or requirement for correction, and when required shall disclose the corrective action taken. Cost of removal, replacement, or correction shall be considered a cost incurred, or to be incurred, when redetermining the prices under the price redetermination clause. However, replacements or corrections by the Contractor after the establishment of the redetermined prices shall be at no increase in the redetermined price.

(h) If the Contractor fails to promptly remove, replace, or correct rejected supplies that are required to be removed or to be replaced or corrected, the Government may either (1) by contract or otherwise, remove, replace, or correct the supplies and equitably reduce the initial contract prices or, if established, the redetermined contract prices or (2) terminate the contract for default. Unless the Contractor corrects or replaces the nonconforming supplies within the delivery schedule, the Contracting Officer may require their delivery and equitably reduce the initial contract price or, if it is established, the redetermined contract prices. Failure to agree upon an equitable price reduction shall be a dispute.

(l) If acceptance is not conclusive for any of the reasons in paragraph (k) hereof, the Government, in addition to any other rights and remedies provided by law, or under other provisions of this contract, shall have the right to require the Contractor (1) at no increase in the initial contract prices, or, if it is established, the redetermined prices of this contract, to correct or replace the defective or nonconforming supplies at the original point of delivery or at the Contractor's plant at the Contracting Officer's election, and in accordance with a reasonable delivery schedule as may be agreed upon between the Contractor and the Contracting Officer; *provided*, that the Contracting Officer may require a reduction in the initial contract prices, or, if it is established, the redetermined prices of this contract, if the Contractor fails to meet such delivery schedule; or (2) within a reasonable time after receipt by the Contractor of notice of defects or nonconformance, to repay such portion of the initial contract prices, or, if it is established, the redetermined prices of this contract, as is equitable under the circumstances if the Contracting Officer elects not to require correction or replacement. When supplies are returned to the Contractor, the Contractor shall bear the transportation costs from the original point of delivery to the Contractor's plant and return to the original point when that point is not the Contractor's plant. If the Contractor fails to perform or act as required in (1) or (2) above and does not cure such failure within a period of 10 days (or such longer period as the Contracting Officer may authorize in writing) after receipt of notice from the Contracting Officer specifying such failure, the Government shall have the right by contract or otherwise to replace or correct such supplies and equitably reduce the initial contract prices, or, if it is established, the redetermined prices of this contract.

(End of clause)
(R 7-2101.19 1976 OCT)

52.246-11 Higher-Level Contract Quality Requirement (Government Specification).

As prescribed in 46.311, insert the following clause in solicitations and contracts when the inclusion of a higher-level contract quality requirement is appropriate (see 46.202-3):

HIGHER-LEVEL CONTRACT QUALITY REQUIREMENT (GOVERNMENT SPECIFICATION)(APR 1984)

(a) Definition. "Contract date," as used in this clause, means the date set for bid opening or, if this is a negotiated contract or a modification, the effective date of this contract or modification.

(b) The Contractor shall comply with the specification titled ..... [*Contracting Officer insert the title and number of the specification*], in effect on the contract date, which is hereby incorporated into this contract.

(End of clause)
(R 7-104.28 1967 AUG)
(R 7-104.33 1967 AUG)

52.246-15 Certificate of Conformance.

As prescribed in 46.315, insert the following clause in solicitations and contracts for supplies or services when the conditions in 46.504 apply:

CERTIFICATE OF CONFORMANCE (APR 1984)

(a) When authorized in writing by the cognizant Contract Administration Office (CAO), the Contractor shall ship with a Certificate of Conformance any supplies for which the contract would otherwise require inspection at source. In no case shall the Government's right to inspect supplies under the inspection provisions of this contract be prejudiced. Shipments of such supplies will not be made under this contract until use of the Certificate of Conformance has been authorized in writing by the CAO, or inspection or inspection and acceptance have occurred.

(b) The Contractor's signed certificate shall be attached to or included on the top copy of the inspection or receiving report distributed to the payment office or attached to the CAO copy when contract administration (Block 10 of the DD Form 250) is performed by the Defense Contract Administration Services. In addition, a copy of the signed certificate shall also be attached to or entered on copies of the inspection or receiving report accompanying the shipment.

(c) The Government has the right to reject defective supplies or services within a reasonable time after delivery by written notification to the Contractor. The Contractor shall in such event promptly replace, correct, or repair the rejected supplies or services at the Contractor's expense.

(d) The certificate shall read as follows:

"I certify that on ..... [*insert date*], the ..... [*insert Contractor's name*] furnished the supplies or services called for by Contract No. ..... via ..... [*Carrier*] on ..... [*identify the bill of lading or shipping document*] in accordance with all applicable requirements. I further certify that the supplies or services are of the quality specified and conform in all respects with the contract requirements, including specifications, drawings, preservation, packaging, packing, marking requirements, and physical item identification (part number), and are in the quantity shown on this or on the attached acceptance document."

Date of Execution: .....
Signature: .....
Title: .....

(End of clause)
(R 7-104.100)

52.246-16 Responsibility for Supplies.

As prescribed in 46.316, insert the following clause in solicitations and contracts for (a) supplies, (b) services involving the furnishing of supplies, or (c) research and development, when a fixed-price contract is contemplated and the contract amount is expected to exceed the small purchase limitation. The contracting officer may use the clause in such solicitations and contracts when the contract amount is not expected to exceed the small purchase limitation, and inclusion of the clause is authorized under agency procedures.

RESPONSIBILITY FOR SUPPLIES (APR 1984)

(a) Title to supplies furnished under this contract shall pass to the Government upon formal acceptance, regardless of when or where the Government takes physical possession, unless the contract specifically provides for earlier passage of title.

(b) Unless the contract specifically provides otherwise, risk of loss of or damage to supplies shall remain with the Contractor until, and shall pass to the Government upon—

(1) Delivery of the supplies to a carrier, if transportation is f.o.b. origin; or

(2) Acceptance by the Government or delivery of the supplies to the Government at the destination specified in the contract, whichever is later, if transportation is f.o.b. destination.

(c) Paragraph (b) above shall not apply to supplies that so fail to conform to contract requirements as to give a right of rejection. The risk of loss of or damage to such nonconforming supplies remains with the Contractor until cure or acceptance. After cure or acceptance, paragraph (b) above shall apply.

(d) Under paragraph (b) above, the Contractor shall not be liable for loss of or damage to supplies caused by the negligence of officers, agents, or employees of the Government acting within the scope of their employment.

(End of clause)
(R 7-103.6 1968 JUN)
(R 1-7.102-6)

tors, manufacturers, or suppliers thereof to execute their warranties, in writing, directly to the Government.

(AV 7-604.4(b) 1976 JUL)

52.246-22 Reserved.

52.246-23 Limitation of Liability.

As prescribed in 46.805(a), insert the following clause in solicitations and contracts when (a) the contract amount is expected to be over $25,000, (b) the contract is subject to the requirements of Subpart 46.8 as indicated in 46.801 and (c) the contract requires delivery of end items that are not high-value items. This clause may also be used as prescribed in 46.805(b) in contracts of $25,000 or less.

LIMITATION OF LIABILITY (APR 1984)

(a) Except as provided in paragraphs (b) and (c) below, and except for remedies expressly provided elsewhere in this contract, the Contractor shall not be liable for loss of or damage to property of the Government (excluding the supplies delivered under this contract) that (1) occurs after Government acceptance of the supplies delivered under this contract and (2) results from any defects or deficiencies in the supplies.

(b) The limitation of liability under paragraph (a) above shall not apply when a defect or deficiency in, or the Government's acceptance of, the supplies results from willful misconduct or lack of good faith on the part of any of the Contractor's managerial personnel. The term "Contractor's managerial personnel," as used in this clause, means the Contractor's directors, officers, and any of the Contractor's managers, superintendents, or equivalent representatives who have supervision or direction of—

(1) All or substantially all of the Contractor's business;

(2) All or substantially all of the Contractor's operations at any one plant, laboratory, or separate location at which the contract is being performed; or

(3) A separate and complete major industrial operation connected with the performance of this contract.

(c) If the Contractor carries insurance, or has established a reserve for self-insurance, covering liability for loss or damage suffered by the Government through purchase or use of the supplies required to be delivered under this contract, the Contractor shall be liable to the Government, to the extent of such insurance or reserve, for loss of or damage to property of the Government occurring after Government acceptance of, and resulting from any defects or deficiencies in, the supplies delivered under this contract.

(d) The Contractor shall include this clause, including this paragraph (d), supplemented as necessary to reflect the relationship of the contracting parties, in all subcontracts.

(End of clause)
(R 7-104.45(a) 1974 APR)

52.246-24 Limitation of Liability—High-Value Items.

As prescribed in 46.805(a), insert the following clause in solicitations and contracts when (a) the contract amount is expected to be over $25,000, (b) the contract is subject to the requirements of Subpart 46.8 as indicated in 46.801 and (c) the contract requires delivery of high-value items:

LIMITATION OF LIABILITY—HIGH-VALUE ITEMS (APR 1984)

(a) Except as provided in paragraphs (b) through (e) below, and notwithstanding any other provision of this contract, the Contractor shall not be liable for loss of or damage to property of the Government (including the supplies delivered under this contract) that (1) occurs after Government acceptance of the supplies delivered under this contract and (2) results from any defects or deficiencies in the supplies.

(b) The limitation of liability under paragraph (a) above shall not apply when a defect or deficiency in, or the Government's acceptance of, the supplies results from willful misconduct or lack of good faith on the part of any of the Contractor's managerial personnel. The term "Contractor's managerial personnel," as used in this clause, means the Contractor's directors, officers, and any of the Contractor's managers, superintendents, or equivalent representatives who have supervision or direction of—

(1) All or substantially all of the Contractor's business;

(2) All or substantially all of the Contractor's operations at any one plant, laboratory, or separate location at which the contract is being performed; or

(3) A separate and complete major industrial operation connected with the performance of this contract.

(c) If the Contractor carries insurance, or has established a reserve for self-insurance, covering liability for loss or damage suffered by the Government through purchase or use of the supplies required to be delivered under this contract, the Contractor shall be liable to the Government, to the extent of such insurance or reserve, for loss of or damage to property of the Government occurring after Government acceptance of, and resulting from any defects or deficiencies in, the supplies delivered under this contract.

(d) (1) This clause does not diminish the Contractor's obligations, to the extent that they arise otherwise under this contract, relating to correction, repair, replacement, or other relief for any defect or deficiency in supplies delivered under this contract.

(2) Unless this is a cost-reimbursement contract, if loss or damage occurs and correction, repair, or replacement is not feasible or desired by the Government, the Contractor shall, as determined by the Contracting Officer—

(i) Pay the Government the amount it would have cost the Contractor to make correction,

repair, or replacement before the loss or damage occurred; or

(ii) Provide other equitable relief.

(e) This clause shall not limit or otherwise affect the Government's rights under clauses, if included in this contract, that cover—

(1) Warranty of technical data;

(2) Ground and flight risks or aircraft flight risks; or

(3) Government property.

(f) In each subcontract, except a subcontract covered by paragraph (g) below, the Contractor shall insert the appropriate clause, supplemented as necessary to reflect the relationship of the contracting parties, as follows:

(1) In subcontracts for high-value items only, after obtaining the Contracting Officer's advance written approval, insert this clause, including this paragraph (f).

(2) In subcontracts for other end items only, insert the clause at Federal Acquisition Regulation (FAR) subsection 52.246-23, Limitation of Liability.

(g) In any subcontract for both high-value items for which this clause is appropriate, and other end items for which the clause at FAR subsection 52.246-23 is appropriate, after obtaining the Contracting Officer's advance written approval to use this clause, the Contractor shall (1) include both clauses, (2) identify high-value items by line item, and (3) insert the following preamble before paragraph (a) of this clause as used in that subcontract:

(This clause shall apply only to those items identified in this contract as being subject to this clause.)

(End of clause)

(R 7-104.45(b) 1979 MAR)

(R 7-204.33(a) 1974 APR)

Alternate I (APR 1984). If the contract is for both high-value items and other end items, the contracting officer shall identify the high-value items by line item and insert the following preamble before paragraph (a):

(This clause shall apply only to those items identified in this contract as being subject to this clause.)

(R 7-104.45(c) 1979 MAR)

(R 7-204.33(b) 1974 APR)

52.246-25 Limitation of Liability—Services.

As prescribed in 46.805(a), insert the following clause in solicitations and contracts when (a) the contract amount is expected to be over $25,000, (b) the contract is subject to the requirements of Subpart 46.8 as indicated in 46.801 and (c) the contract is for services. This clause may also be used as prescribed in 46.805(b) in contracts of $25,000 or less.

LIMITATION OF LIABILITY—SERVICES (APR 1984)

(a) Except as provided in paragraphs (b) and (c) below, and except to the extent that the Contractor is expressly responsible under this contract for deficiencies in the services required to be performed under it (including any materials furnished in conjunction with those services), the Contractor shall not be liable for loss of or damage to property of the Government that (1) occurs after Government acceptance of services performed under this contract and (2) results from any defects or deficiencies in the services performed or materials furnished.

(b) The limitation of liability under paragraph (a) above shall not apply when a defect or deficiency in, or the Government's acceptance of, services performed or materials furnished results from willful misconduct or lack of good faith on the part of any of the Contractor's managerial personnel. The term "Contractor's managerial personnel," as used in this clause, means the Contractor's directors, officers, and any of the Contractor's managers, superintendents, or equivalent representatives who have supervision or direction of—

(1) All or substantially all of the Contractor's business;

(2) All or substantially all of the Contractor's operations at any one plant, laboratory, or separate location at which the contract is being performed; or

(3) A separate and complete major industrial operation connected with the performance of this contract.

(c) If the Contractor carries insurance, or has established a reserve for self-insurance, covering liability for loss or damage suffered by the Government through the Contractor's performance of services or furnishing of materials under this contract, the Contractor shall be liable to the Government, to the extent of such insurance or reserve, for loss of or damage to property of the Government occurring after Government acceptance of, and resulting from any defects and deficiencies in, services performed or materials furnished under this contract.

(d) The Contractor shall include this clause, including this paragraph (d), supplemented as necessary to reflect the relationship of the contracting parties, in all subcontracts over $25,000.

(End of clause)

(R 7-1912 1974 APR)

52.247-1 Commercial Bill of Lading Notations.

(a) As prescribed in 47.104-4(a), in order to ensure the application of section 10721 rates, insert the following clause in solicitations and contracts when the contracts will be—

(1) Cost-reimbursement contracts, including those that may involve the movement of household goods (see 47.104-3(b)); or

(2) Fixed-price f.o.b. origin contracts other than small purchases under Part 13 (see 47.104-2(b) and 47.104-3).

(b) As prescribed in 47.104-4(b), the contracting officer may insert the clause at 52.247-1, Commercial Bill of Lading Notations, in solicitations and contracts awarded under the small purchase procedures in Part

PART 46--QUALITY ASSURANCE
SUBPART 46.1--GENERAL

46.101 Definitions.

"Calibration", is the comparison of a measurement system or device of unverified accuracy to a measurement system or device of known or greater accuracy to detect and correct any variation from required performance specification of the unverified measurement system or device.

"Metrology", is the science of weights and measures used to detemine conformance to technical requirements including the development of standards and systems for absolute and relative measurements.

"Quality", means the composite of material attributes including performance features and characteristics of a product or service to satisfy a given need.

"Quality Assurance", is a planned and systematic pattern of all actions necessary to provide adequate confidence that adequate technical requirements are established; products and services conform to established technical requirements; and satisfactory performance is achieved.

"Quality Audit", is a systematic examination of the acts and decisions with respect to quality in order to independently verify or evaluate the operational requirements of the Quality program or the specification or contract requirements of the product or service.

"Quality Program", is a program which is developed, planned, and managed to carry out cost effectively all efforts to effect the quality of materials and services from concept through validation, full-scale development, production, deployment, and disposal.

46.102 Policy.

(70) The Departments shall develop and manage a cost effective quality program to assure that all services provided and products designed, developed, purchased, produced, stored, distributed, operated, maintained, or disposed of, by contractors for the Department of Defense, conform to specified requirements.

(71) The Departments will plan and implement a quality program as an integral part of all phases of the acquisition and support process, and will conduct quality audits to assure the attainment of quality products and services.

(72) The Government shall determine the type and extent of Government contract quality assurance actions required, based upon the particular acquisition.

(1) These actions may include:

(i) inspection of supplies and services;

(ii) review of the contractor's inspection system, quality program, or other means employed by the contractor to control quality and to comply with contract requirements:

(iii) maintenance of Government records to reflect actions, deficiencies, and corrective measures; and

(iv) review and evaluation of quality data, including reports from the user, to initiate required corrective actions or to adjust Government contract quality assurance actions.

(2) The Government shall hold contractors responsible for the quality of products and services by means of:

(i) contract provisions that place responsibility on contractors;

(ii) the Government's exercising its right to reject or return contractor-responsible defective items for repair, correction or replacement; and

(iii) warranty clauses, when appropriate.

(3) The Government shall consider the use of:

(i) contractual means for encouraging excellence in the conduct of contractor-responsible quality efforts;

(ii) incentive fee or award fee arrangements for achieving quality goals;

(iii) reduced Government surveillance when contractor's quality performance so indicates; and

(iv) other noncontractual motivation techniques.

(4) Contractors shall be provided maximum flexibility in establishing efficient and effective quality programs within specified contractual requirements.

46.103 Contracting Office Responsibilities. The contracting office may conduct, in conjunction, where necessary, with the activity responsible for technical requirements, product-oriented surveys and evaluations to determine the adequacy of the technical requirements relating to quality and product conformance to design intent. The contracting office may arrange with the contract administration office to participate in pre-award surveys, post-award, and preproduction conferences, and first article testing. The contracting office may aid the contract administration office in the transition from research and development to production, aid the technical activity in improving the quality requirements in contracts when first designed for competitive acquisition, and aid in ascertaining the source of difficulties associated with user experience reports.

46.104 Contract Administration Office Responsibilities.

(d) Written instructions from the contracting office shall be continued as prescribed until any recommendation has been acted upon by the contracting office (also see FAR 46.103(c)).

46.170 Organization Responsible for Technical Requirements.

(a) The activity responsible for technical requirements (e.g., specifications, drawings and standards) is responsible for prescribing inspection, testing, or other contract quality requirements that are essential to assure the integrity of products and services.

(b) To the extent feasible, alternative but substantially equivalent inspection methods shall be provided in order to obtain wide competition and low cost. Contractor-recommended alternatives may be authorized when in the interest of the Government and after approval by the activity responsible for technical requirements.

(c) The activity responsible for technical requirements may also prepare instructions regarding the type and extent of Government inspections pertaining to contracts for specific supplies or services that are complex or for which unusual requirements have been established. Such instructions shall be kept to a minimum taking into account the policy contained in 46-474(b). Normally, issuance of these instructions will not be appropriate for standard commercial items except when items having critical characteristics are being purchased. After issuance of these instructions, production problems, product-oriented visits, user experience and input from the contract administration office shall be analyzed periodically to determine whether conditions warrant a change in type and extent of the inspection requirements. Such analysis may result in decreasing or increasing Government inspection. These instructions shall be prepared on a contract-by-contract basis and shall not be issued:

(1) as a substitute for incomplete contract quality requirements;

(2) where the contract does not impose equal or greater inspection requirements on the contractor;

(3) encompassing broad or general designations such as "all requirements", "all characteristics", or "all characteristics in the classification of defects";

(4) on routine administrative procedures; or

(5) specifying continued inspection requirements when statistically sound sampling will provide an adequate degree of protection.

(d) In the preparation of such instructions, the technical activity shall consider, to the extent available and applicable, such factors as:

(1) the past quality history of the contractor;

(2) the criticality of the material acquired in relation to its ultimate use considering such factors as reliability, safety and interchangeability;

(3) problems encountered in the development of the product;

(4) problems encountered in the acquisition of the same or similar material;

(5) previously generated feedback data from receiving, testing or using activities; and

(6) other contractor's experience in overcoming manufacturing problems.

When knowledge of the determining factors, which resulted in the requirement for Government inspection, would be useful to the contract administration office in performing the contract quality assurance function, these factors should be provided to the contract administration office.

DOD FAR SUPPLEMENT

PART 46--QUALITY ASSURANCE
SUBPART 46.2--CONTRACT QUALITY REQUIREMENTS

46.202 Types of Contract Quality Requirements.

46.202-3 Higher-Level Contract Quality Requirements.

(70) Inspection System Requirement is a requirement, in addition to the Standard Inspection Requirement, that the contractor establish and maintain an inspection system in accordance with a Government specification. This requirement shall be referenced in contracts when technical requirements are such as to require control of quality by in-process as well as final end-item inspection, including control of such elements of the manufacturing process as measuring and testing equipment, drawings and changes, inspection, documentation and records. The objectives and essential elements of an inspection system are prescribed in MIL-I-45208, which shall be referenced in contracts when an inspection system requirement has been established.

(71) Quality Program Requirement is a requirement, in addition to the Standard Inspection Requirement, that the contractor establish and maintain a quality program in accordance with a Government specification. Such a requirement shall be established when the technical requirements of the contract are such as to require control of work operations, in-process controls, and inspection, as well as attention to other factors (e.g., organizations, planning, work instructions, documentation control, advanced metrology). The objectives and essential elements of a quality program are prescribed in MIL-Q-9858 which shall be referenced in contract when a quality program requirement has been established.

46.203 Criteria for Use of Contract Quality Requirements.

(c) Criticality. Whether peculiar or common, purchases of critical items must have contract quality requirements.

46.204 Application of Criteria. For DoD the following table implements FAR 46-204, Table 46-1, for higher-level contract quality requirements:

TABLE 46-1
CONTRACT QUALITY REQUIREMENTS GUIDE

Item		Type of Contract	
Technical Description	Complexity	Application	Quality Requirement
Commercial	Complex	Critical	MIL-I-45208
Military-Federal	Non-Complex	Critical	MIL-I-45208
Military-Federal	Complex	Non-Critical Peculiar	MIL-I-45208
Military-Federal	Complex	Critical	MIL-Q-9858

NOTES

CHAPTER H

Subcontract Management

In light of the tremendous dollar value of contracts that primes delegate to subcontractors, it is important that we examine that unique Prime-Sub situation.

The subcontract management section of this textbook will investigate the relationship between the prime and the subcontractor. It will review the position of the government with regard to a critical subcontract. The important Make or Buy decision-making steps will be analyzed.

The subcontractor is responsible to the prime, who in turn is responsible to the government. One of the tools available to the government in determining the responsiveness of a prime in performing the role of managing subcontracts is the Contractor Purchasing System Review (CPSR).

	TOPIC	Page	Assignment
1.	Subcontract Management	H-2 thru H-25	Review
2.	FAR Subsection 9.104-4	H-26	Read
3.	FAR Part 44	H-27 thru H-31	Read
4.	FAR Subsection 52.244-1 thru 52.244-5	H-32 thru H-35	Review
5.	DFARS Part 44	H-36 thru H-39	Review
6.	Handout - "Subcontracting Made Easy"	H-40 thru H-45	Read
7.	Handout- "Am I On The Governments Review List"?	H-46 thru H-48	Read

SCHOOL OF SYSTEM AND LOGISTICS

ADVANCED CONTRACT ADMINISTRATION COURSE (PPM 304)

SUBJECT: Subcontract Management

TIME: 3.5 Hrs

OBJECTIVE: Comprehend the purpose and the function of subcontract controls in CAS.

SAMPLES OF BEHAVIOR:

a. Define the meaning of "consent" in subcontracting.

b. Distinguish the responsibilities between the PCO and the ACO for Subcontract Management.

c. Explain the concept of "privity of relationship" between the government and the prime contractor and subcontractor.

d. Explain policies and procedures related to review and approval of contractor's procurement system.

INSTRUCTIONAL METHODS: Lecture/Discussion
Case Analysis

STUDENT INSTRUCTIONAL MATERIALS: ACA Textbook

REQUIRED STUDENT PREPARATION: As defined in Chapter "H" of the ACA textbook.

Subcontract Management

A sizeable portion of every defense procurement dollar is spent on subcontract work. Thus, much of the defense program is produced by firms in which DOD has no direct contractual relationship. In the absence of a contractual relationship, the Government has no legal basis, except through the prime contract, on which to administer or control a subcontract. Since the subcontracted effort is essential to the ultimate success of the defense program, the Government must ensure that the prime contractor's subcontracting effort is managed in accordance with prudent business practice and the subcontracted work satisfies all current government regulations. The ACO and the CAO team are charged with this responsibility. Specifically, the ACO must work with and monitor the contractor's compliance with "subcontracting" and/or "Make or Buy" clauses that are conditionally included in contracts assigned for administration.

Generally, consent to subcontracts is required when the subcontract work is complex, the dollar value is substantial, or the Government's interest is not adequately protected by competition and the type of prime contract or subcontract. The inclusion of "make or buy" provisions in a contract is determined by the buying activity. It is included when necessary to ensure the negotiation of reasonable contract prices, satisfactory contract performance or implementation of socioeconomic policies.

Subcontracts Clauses

Describe what the subcontract clauses in the prime contract require of the contractor and government representative.

Although the specific clauses vary depending upon the type of prime contract (fixed price, cost reimbursement and letter contracts, time and material and labor hour) in essence, the clause requires the prime contractor to give advance notification and written justification of procurements to the ACO. The ACO must provide written consent. However, if the contractor's purchasing system is approved, certain requirements are waived. The approval of the contractor's purchasing system is discussed later in section 8-2.

A closer inspection of the Fixed Price contract clause will illustrate the requirements levied on the prime contractor and ACO. We will look at the paragraphs of the clause individually.

> SUBCONTRACTS UNDER FIXED PRICE CONTRACTS (APR 1984)
>
> (a) This clause does not apply to firm fixed price contracts and fixed price with economic price adjustment. However, it does apply to

subcontracts resulting from unpriced modifications to such contracts.

In these specific types of contracts, the total cost risk is borne by the prime contractor. Therefore, the Government's interests are protected by the type of prime contract. When the governments interests are protected by type of prime contract, our involvement in how the contractor subcontracts is negligible. However, unpriced modifications create conditions similar to a cost reimbursement contract as their structure places maximum cost risk on the Government. When the Government assumes great cost risks, involvement by the ACO to protect the government's interests is essential.

(b) "Subcontract," as used in this clause, includes but is not limited to purchase orders, and changes and modifications to purchase orders. The Contractor shall notify the Contracting Officer reasonably in advance of entering into any subcontract if the Contractor does not have an approved purchasing system and if the subcontract-

(1) Is to be a cost-reimbursement, time and-materials, or labor-hour contract estimated to exceed $25,000 including any fee.

(2) Is proposed to exceed $100,000.

(3) Is one of a number of subcontracts with a single subcontractor, under this contract, for the same or related supplies or services, that in the aggregate are expected to exceed $100,000.

This paragraph specifically defines the conditions in which the Government's interest are not protected by the type of subcontract or is of significant dollar value. It requires the prime contractor to notify the government in advance of entering into a subcontract, unless the prime contractor's purchasing system has been approved by the Government.

(c) The advance notification required by paragraph above shall include:

(1) A description of the supplies or services to be subcontracted;

(2) Identification of the type of subcontract to be used;

(3) Identification of the proposed subcontractor and an explanation of why and how the proposed subcontractor was selected, including the competition obtained;

(4) The proposed subcontract price and the Contractor's cost or price analysis;

(5) The subcontractor's current, complete, and accurate cost or pricing data and Certificate of Current Cost or Pricing Data, if required by other contract provisions;

(6) The subcontractor's Disclosure statement or Certificate relating to Cost Accounting Standards when such data are required by other provisions of this contract; and

(7) A negotiation memorandum reflecting:

(i) The principal elements of the subcontract price negotiations.

(ii) The most significant considerations controlling establishment of initial or revised prices.

(iii) The reason cost or pricing data were or were not required.

(iv) The extent, if any, to which the Contractor did not rely on the subcontractor's cost or pricing data in determining the price objective and in negotiating the final price.

(v) The extent, if any, to which it was recognized in the negotiation that the subcontractor's cost or pricing data were not accurate, complete, or current; the action taken by the contractor and subcontractor; and the effect of any such defective data on the total price negotiated.

(vi) The reasons for any significant difference between the contractor's price objective and the price negotiated; and

(vii) A complete explanation of the incentive fee or profit plan when incentives are used. The explanation shall identify each critical performance element, management decisions used to quantify each incentive element, reasons for the incentives, and a summary of all trade-off possibilities considered.

Paragraph (c) describes the specific information to be provided the Government, almost always the cognizant ACO. Upon receipt of the advance notice, the ACO is responsible for a timely evaluation. During the evaluation, the ACO should involve other team members such as audit, technical, price and subcontract specialists, as necessary so the decision to grant or withhold consent is justifiable:

Careful and thorough consideration is particularly appropriate when any of the following conditions exist.

a. The prime contractor's purchasing system or performance is inadequate.

b. Close working relationships or ownership affiliations between the prime and subcontractor may preclude free competition or result in higher prices.

c. Subcontracts are proposed for award on a non-competitive basis, at prices that appear unreasonable, or at prices higher than those offered to the Government in comparable circumstances.

d. Subcontracts are proposed on a cost-reimbursement, time-and-materials, or labor-hour basis.

Whichever decision is made must reflect prudent business judgment and should reflect consideration of the following questions:

a. Is the decision to subcontract consistent with the contractor's approved make-or-buy program, if any? (see FAR Subpart 15.7)

b. Is the subcontract for special test equipment or facilities that are available from government sources? (see FAR Subpart 45.3)

c. Is the selection of the particular supplies, equipment, or services technically justified?

d. Has the contractor complied with the prime contract requirements regarding labor surplus area or small business subcontracting, including, if applicable, its plan for subcontracting with small business concerns and small disadvantaged business concerns? (see FAR Part 19)

e. Was adequate price competition obtained or its absence properly justified?

f. Did the contractor adequately assess and dispose of subcontractor's alternate proposals, if offered?

g. Does the contractor have a sound basis for selecting and determining the responsibility of the particular subcontractor?

h. Has the contractor performed adequate cost or price analysis or price comparisons and obtained accurate, complete, and current cost or pricing data, including any required certifications?

i. Is the proposed subcontract type appropriate for the risks involved and consistent with current policy?

j. Has adequate consideration been obtained for any proposed subcontract that will involve the use of government-furnished facilities?

k. Has the contractor adequately and reasonably translated prime contract technical requirements into subcontract requirements?

l. Does the prime contractor comply with applicable cost accounting standards for awarding the subcontract?

m. Is the proposed subcontractor on the Consolidated List of Debarred, Suspended, and Ineligible Contractors? (see FAR Subpart 9.4)

After evaluating these areas, the decision to grant or withhold consent is solely the responsibility of the ACO. However, consent must be withheld when any of the following conditions exist. Consent must be withheld when the proposed subcontract:

a. Is a cost-reimbursement type and the fee exceeds the limitations of the FAR.

b. Provides for payment on a cost plus percentage of cost basis.

c. Obligates the government's Contracting Officer to deal directly with the subcontractor.

d. Would make agreements between the prime contractor and subcontractor binding on the Government.

As discussed, the conditions necessitating mandatory withholding of consent are precise. Excepting these mandatory rejection factors, the ACO must use the much less precise standard of what is in the best interest of the Government, considering all factors, when deciding to grant or withhold consent.

(d) The contractor shall obtain the Contracting Officer's written consent before placing any subcontract for which advance notification is required under paragraph (b) above. However, the Contracting Officer may ratify in writing any such

subcontract. Ratification shall constitute the consent of the Contracting Officer.

Obviously, this paragraph requires the prime contractor to obtain the government's consent prior to awarding the proposed subcontract. However, ratification (after the fact approval) is permitted. Since ratification is never automatic, contractors should conduct their business so this type of action is avoided. The ACO, as a matter practice, can only ratify actions that are in the Government's best interest. Therefore, the prime contractor and ACO should establish a working relationship which doesn't jeopardize the interests of either party.

(e) Even if the contractor's purchasing system has been approved, the contractor shall obtain the Contracting Officer's written consent before placing subcontracts that have been selected for special surveillance and so identified in the Schedule of this contract.

This paragraph requires the prime contractor to obtain consent prior t award of any subcontract selected for special surveillance and so identified in the prime contract. Special surveillance of subcontract effort may be included in a prime contract for a variety of reasons. From a contract administration perspective the reason for incorporation is inconsequential since ensuring prime contractor's compliance with the contract is the ACO's principal concern.

(f) Unless the consent or approval specifically provides otherwise, neither consent by the Contracting Officer to any subcontract nor approval of the contractor's purchasing system shall constitute a determination (1) of the acceptability of any subcontract terms or conditions, (2) of the acceptability of any subcontract price or of any amount paid under any subcontract, or (3) to relieve the contractor of any responsibility for performing this contract.

This paragraph specifically defines what consent does not imply. However, to clearly understand the meaning of consent, it's importance to understand its legal implications.

The prime contractor is the party having a direct contractual relationship with the Government. There is no such relationship between the Government and the subcontractor or, as it is usually phrased, there is no privity of contract between the Government and the subcontractor. The law relating to subcontracts is built around this no-privity rule. The fact that the prime contract requires advance government consent to placing a subcontract does not place the subcontractor in a direct relationship with the

Government. No privity applies even when the subcontract is subject to all the terms and conditions of the prime contract.

The contract type is not important in applying the no-privity rule. For example, a cost type prime contract should not raise the presumption that there is a direct contractual relationship between the Government and subcontractors. When the Government enters into a contract and specifies brand names, the brand name manufacturer is still regarded as a subcontractor and has no standing in court relative to the Government. An exception to the no-privity rule occurs when a prime contractor acts as an agent of the Government for the purpose of buying goods or services on behalf of or in the name of the Government. In such instances, the subcontractor and the Government have such a close contractual relationship privity may exist.

In order that the ACO's consent to a proposed subcontract will not be misunderstood or given a meaning not intended, it is furnished to the contractor in a written notice essentially as stated below:

> Consent is hereby given to the placement of subject proposed subcontract or purchase order, subject to the clauses contained in the prime contract and conditional upon the information furnished by the contractor in support thereof. This consent shall in no way relieve the prime contractor of any obligations or responsibilities it may otherwise have under the contract or under law, shall neither create any obligation of the Government to, nor privity of contract with, the subcontractor or vendor, and shall be without prejudice to any right or claim of the Government under the prime contract. This consent does not constitute a determination as to the acceptability of the subcontract price or the allowability of costs.

This says, in effect, the relationships between the prime contractor and a subcontractor and between the Government and a subcontractor are the same under a subcontract for which consent is granted as under a subcontract not requiring consent. Such problems as subcontract prices that are not fair and reasonable, delays caused by the subcontractor, defective supplies furnished by the subcontractor, or a strike at the subcontractor's plant are treated in the same fashion, regardless of whether or not the subcontract required and was granted consent. However, when a contract requires consent to a proposed subcontract, any arbitrary or unreasonable delay on the part of the ACO in granting consent may be regarded as excusable delay to the contractor.

(g) No subcontract placed under the contract shall provide for payment on cost-plus-a-percentage -of-cost basis, and any fee payable under cost -reimbursement subcontracts shall not exceed the fee limitations in subsection 16.301-4 of the Federal Acquisition Regulation (FAR).

(h) The Government reserves the right to review the contractor's purchasing system as set forth in FAR Subpart 44.3.

(End of clause)

Paragraph (g) clearly renounces any subcontracts which provide for payment of fees prohibited by law and the FAR. Paragraph (h) asserts the Governments' right to review the contractor's purchasing system. Review of the contractor's purchasing system is discussed in section 8-2. For brevity, the consent requirements of other contract types are outlined below.

Cost-Reimbursement and Letter Prime Contracts

a. Consent is required under cost-reimbursement and letter prime contracts, except facilities contracts, for subcontracts for fabrication, purchase, rental, installation, or other acquisition of special test equipment valued at more than $10,000 or of any items of industrial facilities, or that have experimental developmental or research work as one of their purposes.

b. If the contractor does not have an approved purchasing system, consent is also required, under cost-reimbursement and letter prime contracts for cost-reimbursement, time-and materials, or labor-hour subcontracts and fixed-price subcontracts that exceed either $25,000 or 5 percent of the total estimated cost of the prime contract.

c. If the contractor has an approved purchasing system, consent is not required for the subcontracts identified in paragraph b. but advance notification is still required by 10 U.S.C. 2306(e) or 41 U.S.C. 254(b).

d. In contracts for acquisition of major systems, subsystems, or their components, consent is required for the subcontract identified in paragraph b, even though the contractor has an approved purchasing system.

Other Prime Contracts. Except for purchase of raw material or commercial stock items, consent is required for all subcontracts under time-and-material contracts. Consent is required for subcontracts under contracts for architect-engineer services, mortuary services, refuse service, or shipment and storage of personal property when an agency requires proper approval of subcontractor's facilities.

Review of the Contractor's Purchasing System

Identify the conditions which must exist before a contractor's purchasing system is reviewed and describe the review procedure(s).

As was noted in the preceding discussion of the subcontract clauses, the Government reserves the right to review the contractor's purchasing system. However it is neither practical nor desirable to review all contract. FAR Part 44 provides the regulatory guidance for conducting these reviews.

The objective of a contractor purchasing system review (CPSR) is to evaluate the efficiency and effectiveness with which the contractor spends Government funds and complies with Government policy when subcontracting. The review provides the ACO with a basis for granting, withholding, or withdrawing approval of the contractor's purchasing system.

A CPSR is conducted by the cognizant administering agency for each contractor whose negotiated sales to the Government are expected to exceed $10 million during the next 12 months. Such sales include those represented by prime contracts, subcontracts under Government prime contracts, and modifications to competitively awarded contracts and formally advertised contracts except when the negotiated price is based on established catalog or market prices of commercial items sold in substantial quantities to the general public, or set by law or regulation. The head of the agency responsible for contract administration may raise or lower the $10 million review level if such action is considered to be in the Government's best interest. Generally, a CPSR is not performed for a specific contract.

A CPSR shall be conducted by the cognizant contract administration agency at least every three years for contractors which continue to meet the requirements of the above paragraph. This review may be accomplished at one time or on a continuing

basis. A more frequent review cycle may be established if warranted and special reviews may be conducted when information reveals a deficiency or major change in the contractor's purchasing system.

Types of Review. Reviews are classified as initial, subsequent, and special. Each review is subject to follow-up.

Initial Review. An initial review is conducted when the contractor first meets the criterion above.

Subsequent Review. A subsequent review is conducted of all contractors who have had an initial review, still meet the basic criterion for review, and have approved systems. The subsequent review may be curtailed to cover areas of interest and weaknesses but must include sufficient consideration of the key factors of a complete evaluation to establish the current adequacy or inadequacy of the entire system.

Special Reviews of Approved Systems. After approval of the contractor's procurement system, the procurement system analyst (PSA) with the concurrence of the ACO, may initiate special reviews in connection with weaknesses revealed as a result of:

a. Initial or subsequent reviews.

b. Review of subcontracts submitted under the notification requirement of contract clauses.

c. Major changes in the contractor's procurement procedures, or key personnel.

d. Changes in plant workload or type of work.

e. Information provided by Government personnel.

Review of Procurement System When Approval is Withheld or Withdrawn. If approval of a contractor's procurement system is withheld or withdrawn, a follow-up review is conducted when evidence is received from the contractor that the deficiencies have been corrected. Whether the follow-up review consists of a complete reexamination of the contractor's procurement system or is confined to the areas found deficient is a matter of judgment.

Extent of Review. Generally, a review consists of a complete evaluation of a contractor's procurement system when the procurement system has not been reviewed before, a past review has resulted in withholding or withdrawal of approval of the system, or a major change in a contractor's procurement organization indicates the need for a new review. The review is made in accordance with DAR Supplement Number 1 (which is incorporated into the DoD FAR Supplement by reference). During the review, special attention is given to the following matters:

a. The degree of price competition obtained.

b. Pricing policies and techniques, including methods of obtaining accurate, complete, and current cost or pricing data and certification as required.

c. Methods of evaluating subcontractor's responsibility.

d. Treatment accorded affiliates and other concerns having close working arrangements with the contractor.

e. Policies and procedures pertaining to labor surplus area concerns and small business concerns, including small disadvantaged business concerns.

f. Planning, award, and post-award management of major subcontract programs.

g. Compliance with Cost Accounting Standards in awarding subcontracts.

h. Appropriateness of types of contracts used.

In reviewing the contractor's procurement system, a determination must be made as to whether subcontracting is done competitively to the maximum practicable extent. This requires ascertaining whether a sufficient number of sources are solicited and whether subcontracting procedures provide other elements of adequate and effective price competition.

Planning the CPSR. Planning for an initial or annual review of a procurement system begins well in advance of the actual review. The quality of the planning will determine, to a large extent, the success or failure of the review itself. Maximum use should be made of reports and information from the Defense Contract Audit Agency (DCAA) or other government personnel.

Review Team. Usually, a team of three or more government personnel reviews a contractor's system. The size of the team may vary, depending, for example, on the size of the contractor and the type of review being conducted. However, the team should be large enough to permit an in-depth review in a reasonable time.

In selecting the team, consideration should be given to the background and skills of the members. The team should be able to take a broad view of the contractor's operations and to give proper emphasis to those areas to be covered by the review.

The team captain is the senior Procurement Systems Analyst (PSA). The team leader assigns the work effort, determines responsibilities of individual team members, and has overall responsibility for the report.

The ACO notifies the contractor of the proposed review and requests any information and data, not otherwise available, the team captain needs to plan and conduct the review. The team

captain should visit the contractor at least one month prior to starting of the initial review to make necessary arrangements with contractor personnel. Concurrent coordination with the small business specialist, price and cost analyst, technical staff, audit service, and other Government offices is necessary. During the planning period, the team captain should accumulate information that the team will need. The following material concerning the contractor is normally obtained:

a. Copies of the company organization charts for the plant being reviewed, showing the company management structure down to at least the department head level.

b. Copies of the purchasing organization chart down to at least the first level of supervision, showing the number and job classification of personnel reporting to each first level and higher supervisor.

c. Copies of purchasing policy statements.

d. Copies of purchasing procedures.

e. Copies of all important purchasing forms.

f. A summary of purchasing actions through the most recent fiscal period.

g. Summary of sales volume for the most recent 12 month period for which information is reasonably available, indicating commercial sales and Government sales by agencies, broken down by type of contract.

h. List of major subcontracts outstanding, showing subcontractor's name, item being produced, type of subcontract, total dollar amount, and undelivered balance.

i. List of major products, broken down by project name or description, total value, and undelivered balance.

j. Copies of weekly or monthly management reports, such as shortage reports, workload and work backlog reports, scrap and salvage reports, and repetitive reports to company management and the Government.

k. Copies of any pertinent reports on the contractor's purchasing system.

l. List of affiliates and autonomous or semi-autonomous department and divisions.

CPSR Areas of Review. The following areas are highlighted during a CPSR:

a. A brief detailed company history and the dollar value of Government prime contracts and subcontracts. Significant commercial programs should also be noted.

b. Determination of whether management officials are aware of the policies and practices of their purchasing organization, familiar with their key subcontractors, and responsive to operating problems in the purchasing area.

c. Analysis of the contractor's organization to develop a clear understanding of the functional relationships of purchasing to manufacturing, quality control, engineering, and so forth. It should be determined whether the organizational level of the purchasing department allows it to operate at maximum effectiveness. (While certain functions may not be organizationally under procurement, they must be responsive to the requirements of procurement.)

d. Review standards governing the qualifications, training, experience, and adequacy of the contractor's procurement staff. It should also consider the adequacy of internal report requirements, controls, documentation, and other management techniques, as well as the procurement staff's responsiveness thereto.

e. Review and evaluate contractor programs such as parts standardization, value analysis, and small business and labor surplus area subcontracting.

f. Study contractor's subcontracting effort to assure subcontracts contain clauses required by the prime contract as well as any clauses needed to carry out the requirements of the prime contract. Subcontract clauses to be considered are those usually referred to as general or standard provisions, as distinguished from terms covering work or item description. Since the Government does not have a direct contractual relationship with subcontractors, subcontract terms are the primary means by which Government's rights are protected. It is the contractor's responsibility to assure that the subcontract terms accomplish this objective.

g. Evaluation of the material control process aspects that relate to the purchasing function. The term "material control", as used here, includes determining the needs, scheduling deliveries, purchasing, expediting, receiving, and controlling inventories of material. Although certain of these functions usually will be performed by departments other than purchasing, an investigation should be made of the contractor's material control system and how it permits purchasing to be accomplished.

h. Review how the contractor's inventory policy affects its method of determining purchase requirements. In reviewing this function, consideration should be given to the contractor

procedures for consolidating requirements, covering scrap, and mitigating potential obsolescence cost.

i. Determine if the contractor has the necessary written policies on intracompany transactions. Policies giving preference to affiliates or divisions on purchased items are not necessarily undesirable. The Government does, however, establish and place restrictions on items transferred between plants under common control. Contractor's policies which favor affiliates should be carefully analyzed to assure the Government's interests are protected.

j. Determine if the contractor has a continuing program to review existing single-source and sole-source items. Contractors are encouraged to handle each specific single-source procurement as an exception to company policy.

k. Analyze if the contractor is implementing the Government's small business policy. Any substantive deviation from Government policy should be reported to the small business specialist including appropriate recommendations on problems encountered.

ACO Responsibilities in Granting, Withholding, or Withdrawing Approval. The cognizant ACO is responsible for granting, withholding, or withdrawing approval of a contractor's purchasing system. The ACO shall:

a. Approve a purchasing system only after a CPSR discloses the contractor's purchasing policies and practices are efficient and provide adequate protection of the Government's interests.

b. Between CPSRs, determine annually whether there are any significant deviations from approved policies and practices that would indicate a need for a special review;

c. Promptly notify the contractor in writing of the granting, withholding, or withdrawing of approval.

If, upon expiration of approval of the contractor's purchasing system, the ACO has not specifically withheld, continued, or withdrawn approval, the approval shall continue for another 90 days. Any further extension requires written approval at least one level higher than the ACO.

Notification. The notification granting initial system approval or continuation of system approval shall include:

a. Identification of the plant or plants where the review was conducted.

b. The effective date of approval and period for which approval is valid.

c. A statement that system approval:

(1) applies to all Federal Government contracts at that plant to the extent that cross-servicing arrangements exist.

(2) waives the contractual requirement for advance notification in fixed-price contracts, but not for cost-reimbursement contracts.

(3) waives the contractual requirement for consent to subcontracts in fixed-price contracts and for specified subcontracts in cost-reimbursement contracts but not for those subcontracts selected for special surveillance and identified in the contract schedule.

(4) shall automatically terminate at the end of the approval period.

(5) shall automatically terminate when any significant change occurs in the system unless approved by the ACO.

(6) may be withdrawn at any time at the ACO's discretion.

In exceptional circumstances, consent to certain subcontracts or classes of subcontracts may be required even though the contractor's purchasing system has been approved. The system approved notification shall identify the class or classes of subcontracts requiring consent. Reasons for selecting these subcontracts may be a CPSR or continuing surveillance has revealed sufficient weaknesses in a particular area of subcontracting to warrant special attention by the ACO.

When recommendations are made for improvement of an approved system, the contractor shall be requested to reply within 15 days with a position regarding the recommendations.

Withholding or Withdrawing Approval. The ACO shall withhold or withdraw approval of a contractor's purchasing system when there are major weaknesses or when the contractor is unable to provide sufficient information upon which to make an affirmative determination. The ACO may withdraw approval at any time if a determination is made that there has been a deterioration of the contractor's purchasing system or to protect the Government's interest. Approval shall be withheld or withdrawn when there is a recurring noncompliance with requirements, including but not limited to:

a. Cost or pricing data.

b. Implementation of cost accounting standards.

c. Advance notification as required by the clauses prescribed in FAR 44.204.

d. Small business subcontracting.

When approval of the contractor's purchasing system is withheld or withdrawn, the ACO shall within 10 days after completing the in-plant review, inform the contractor in writing. He or she will specify the deficiencies that must be corrected to qualify the system for approval, and request the contractor furnish, within 15 days, a plan for accomplishing the necessary actions. If the plan is accepted, the ACO shall make a follow-up review as soon as the contractor notifies the ACO the deficiencies have been corrected.

Communicating Approval Status. Upon request, the ACO may inform a contractor the purchasing system of a proposed subcontractor has been approved, but shall caution that the Government will not keep the contractor advised of any changes in the approval status. If the proposed subcontractor's purchasing system has not been examined or approved, the contractor shall be advised. When recommendations are made for improvement of an approved system, the contractor will be requested to reply as soon as possible with its concurrence to the recommendations.

Reports. The ACO distributes copies of CPSR reports, notifications granting, continuing, withholding, or withdrawing system approval; and government recommendations for improvement of an approved system, including the contractor's response, to at least the contractor's cognizant contract audit office activities.

The notification of approval will be in substantially the following form:

TO: (Contractor)

> As a result of the recent review of your procurement system at_____(identify the plant or plants involved), you are advised of_____ (insert "my approval") of your procurement system. This approval, effective_____ (date) is for a period of one year and is applicable to all of your contracts at the above plant or plants with the Department of Defense. This approval waives to the extent provided in your contracts, the contractual requirements for prior consent by the contracting officer to the placement of certain subcontracts. In addition, it waives, to the extent provided in fixed-price contracts, the requirement for advance notification to the contracting officer of your intent to place certain subcontracts. This approval does not eliminate the requirement under cost-reimbursement contracts for advance notification to the contracting officer of your

intent to place proposed subcontracts where such notification is required, nor does it affect any contractual provisions which require prior consent to the placement of subcontracts not withstanding this approval of your procurement system. (If special requirements for continued notification and prior consent for one or more classes of subcontracts are to be imposed, such special requirements should be inserted here.) This approval of your procurement system:

(i) Shall not be construed to be a determination of any subcontract price or of any amount paid under any subcontract, or to relieve you of any contractual requirement, except as specified herein.

(ii) Shall automatically terminate upon the expiration date specified above unless the expiration date is extended.

(iii) Shall automatically terminate when any significant change occurs in your procurement system unless the change has received my approval.

(iv) may be withdrawn at any time at my discretion.

You are to be commended that your procurement system merits Government approval, and you are urged to continue your efforts to maintain an acceptable procurement system.

_____
Contracting Officer

In exceptional circumstances, the approval may require notification and prior written consent for one or more classes of subcontracts which, because of their critical nature or particular circumstances call for extraordinary Government surveillance. Such requirements will not be based upon the dollar amount of proposed subcontracts and, if imposed, will be removed at the earliest possible date.

Disclosure of Approval Status. Information obtained during the CPSR should be divulged only to those Government personnel having a need-to know. Upon request, a prime contractor may be informed that the procurement system of a proposed subcontractor has been approved under Government prime contracts, as stated above.

ACO Surveillance. In the period between complete CPSRs, the ACO maintain a sufficient level of surveillance to assure the contractor is effectively managing its purchasing

program. The ACO make a determination annually to continue approval based on surveillance, or request a CPSR or special review as a basis for continuing or withdrawing approval.

Surveillance is accomplished in accordance with a plan developed by the ACO with the assistance of subcontracting, audit, pricing, technical, or other specialists as necessary. The plan covers pertinent phases of a contractor's purchasing system such as preaward, post-award, performance, and contract completion and pertinent operations that affect the contractor's purchasing and subcontracting. The plan also provides for reviewing the effectiveness of the contractor's corrective actions taken as a result of previous Government recommendations.

Make-or-Buy Program

Describe a make-or buy-program and the ACO's responsibility under a make-or-buy program.

Although the Government does not expect to participate in every management decision of the prime, it may reserve the right to review the contractor's proposed make-or-buy program when necessary to ensure negotiation of reasonable contract prices, satisfactory performance, and implementation of socioeconomic policies.

Definition and Criteria. A make-or-buy program is that part of a contractor's written plan which identifies the major subsystem, assemblies, subassemblies, and components to be manufactured, developed, or assembled in his/her own facilities and those which will be obtained elsewhere by subcontract. A "make" item is any item produced, or work performed, by the contractor, affiliates, subsidiaries, or divisions.

Information with respect to prospective contractor's make-or-buy program is required in negotiated procurements except:

a. When a proposed contract has a total estimated value of less than $2 million, unless such information is appropriate.

b. In research and development contracts, unless the contract is for prototypes or hardware and it can reasonably be anticipated that significant follow-on quantities of the product will be procured.

c. When the contracting officer determines the price is based on adequate price competition, or established catalog or market prices of commercial items sold in substantial quantities to the general public, or on prices set by law or regulation.

d. When the contracting officer determines the work is not complex.

Information with respect to make-or-buy programs to be included in any contract should be confined to items which, because of their complexity, quantity, cost or need for additional production facilities, normally would require company management review of the make-or-buy decision. As a general guideline, the make-or-buy program should not include items or work efforts costing less than one percent of the total estimated contract price or $500,000, whichever is less.

Review and Evaluation. When submission of information with respect to a prospective contractor's proposed make-or-buy program is required, the solicitation should clearly establish any special evaluation factors. The contractor should consider many factors such as capability, capacity, availability of small business, contract schedules, integration control, proprietary processes, and technical superiority in the make-buy plan. Having considered these factors, the prospective contractor must identify in the proposed make-or-buy program work which the contractor, affiliates, or subsidiaries must perform as "must make"; must subcontract as "must buy"; and can perform or acquire by subcontracts as "can make or buy". The prospective contractor must state the reasons for recommendations of "must make" or "must buy" in sufficient detail for the contracting officer to determine sound business and technical judgment has been applied to each major element of the program.

It frequently happens that the design status of the article being procured does not permit accurate pre-contract identification of major items that should be included in the make-or-buy program. When this is the case and the make-or-buy program is to be incorporated into the contract, the prospective contractor should be notified that such items must be added to the program, when identified, under the "Changes to Make-or-Buy Program" clause.

The prospective contractor furnishes the following with the proposed make-or-buy program:

a. A description by which each major item can be identified.

b. A recommendation to make or buy each such item or defer the decision.

c. The proposed subcontractors, if known, including location and size classification.

d. Designation of the plants or divisions in which the contractor proposes to make the item whether the facility is in or near a section of concentrated unemployment or underemployment.

e. Sufficient additional information to permit the contracting officer to evaluate the proposed program.

In reviewing and evaluating a proposed make-or-buy program, the contracting officer will assure all appropriate items are included and will delete items which should not be included. In conducting the review, the contracting officer should obtain the advice of appropriate personnel, including small business and contract administration activity specialists, whose knowledge can contribute to the effectiveness of the review.

The contractor has the basic responsibility for make-or-buy decisions. Therefore, the contractor's recommendations should be accepted unless there are adverse affects on the Government's interest or they are inconsistent with Government policy.

Proposed "make" items normally will not be agreed to when the products or services under consideration are:

a. Not regularly manufactured or provided by the contractor, and are available from other firms at prices no higher than if the contractor should make or provide the products or services.

b. Regularly manufactured or provided by the contractor, but are available from other firms at lower prices.

There may be cases where it is proper to agree that an item of significant value will be "bought" even though it would usually be more economical to have it "made", or vice versa. For instance, the contractor may have a unique capability for low cost manufacture of a substantial component but capacity may be full during the period necessary for contract performance, so the component must be subcontracted. In such cases it will be necessary that the make-or-buy program specifically calls for more costly treatment of the item. In that event, the consequent higher costs may be recognized in establishing the best obtainable contract or target price. Unforeseen changes in the circumstances may arise during contract performance, which induce the contractor to propose changing the item from "buy" to "make", or vice versa. If such a change is made, the element of the contract price which was intended to compensate the contractor for the higher costs flowing from the initial

make-or-buy decision would instead constitute windfall profits to the contractor and unwarranted costs to the Government.

When, during the review of the prospective contractor's make-or-buy program, a situation of the kind described above is found to exist, the clause set forth below is included in the contract. Items are specifically designated in the contract as being either a "make" item or a "buy" item, and as being subject to this clause.

CHANGES OR ADDITIONS TO MAKE-OR-BUY PROGRAM (APR 1984)

(a) The Contractor shall perform in accordance with the make-or-buy program incorporated in this contract. If the Contractor proposes to change the program, the Contractor shall, reasonably in advance of the proposed change; (1) notify the Contracting Officer in writing; and, (2) submit justification in sufficient detail to permit evaluation. Changes in the place of performance of any "make" items in the program are subject to this requirement.

(b) For items deferred at the time of negotiation of this contract for later addition to the program, the Contractor shall, at the earliest possible time; (1) notify the Contracting Officer of each proposed addition and (2) provide justification in sufficient detail to permit evaluation.

(c) Modification of the make-or-buy program to incorporate proposed changes or additions shall be effective upon the Contractor's receipt of the Contracting Officer's written approval.

(End of clause)

Assistance by Contract Administration Activities. Contract administration activities generally are in a position to provide valuable assistance to purchasing offices in implementing DOD make-or-buy policies and procedures. The various specialty groups represented in the field offices usually have a very good knowledge of a contractor's technical capability as well as the capacity of its plant for production of parts, components, and subsystems. They are also able to identify, with a reasonable degree of confidence, the impact of make-or-buy decisions on in-house backlog, congestion, or other plant capacity problems.

Before the contractor's proposed make-or-buy plan is evaluated, the contract administration activity must have full knowledge of the criteria for establishment of the plan. The following factors should be considered:

a. Has the procuring activity directed a certain percentage of the effort to be subcontracted?

b. Has a certain percentage been directed to be subcontracted to small business, labor surplus, or distress areas?

c. Has a certain component been directed to be subcontracted to broaden the industrial base?

d. Has a certain component been directed to be subcontracted due to proprietary rights or other reasons?

Some of the factors to be considered by the contract administration activity in evaluating the make-or-buy plan for the purpose of making recommendations to the buying activity would be:

a. Are the "make" items similar and consistent with those normally manufactured by the contractor? If not, is the capability being developed at an increase in total cost to the Government? Does the contractor have the technical capability? Assuming the total price to the Government is acceptable, is the delivery risk factor acceptable?

b. Do the "make" items require additional facilities? If so, are additional government facilities required? If additional government facilities are required, are they clearly and substantially identified in the plan?

c. Do the "make" or "buy" prices include proper prorated tooling costs, transportation costs, costs of special handling for unique or sensitive components, additional government facilities costs, and any other costs that may be allocable costs to the contract?

d. Are "make-or-buy" decisions pending on other programs that affect the same period of effort?

While the PCO is responsible for establishing the make-or-buy program in the negotiation of the contract, the ACO is responsible for the administration of the contract's make-or-buy provisions. The ACO must make recommendations in connection with proposed changes or revisions to the original make-or-buy schedule, negotiate any contract price change resulting therefrom, and prepare and execute the required supplemental agreement when authorized by the PCO.

In the administration of the make-or-buy program, it is the responsibility of the ACO to:

a. Monitor the make-or-buy schedule to assure compliance therewith by the contractor.

b. Assure the contractor establishes a program that will provide for the submission of any proposed changes.

c. Consent to or deny requested changes in the schedule, when authorized by the PCO,

d. Make recommendations to the PCO with regard to additions to the schedule concerning items reserved for deferred decision or unidentified at the time of the contract negotiation.

9.104-4 Subcontractor responsibility.

(a) Generally, prospective prime contractors are responsible for determining the responsibility of their prospective subcontractors (but see 9.405 and 9.405-2 regarding debarred, ineligible, or suspended firms). Determinations of prospective subcontractor responsibility may affect the Government's determination of the prospective prime contractor's responsibility. A prospective contractor may be required to provide written evidence of a proposed subcontractor's responsibility.

(b) When it is in the Government's interest to do so, the contracting officer may directly determine a prospective subcontractor's responsibility (e.g., when the prospective contract involves medical supplies, urgent requirements, or substantial subcontracting). In this case, the same standards used to determine a prime contractor's responsibility shall be used by the Government to determine subcontractor responsibility.

PART 44

SUBCONTRACTING POLICIES AND PROCEDURES

44.000 Scope of part.

This part prescribes policies and procedures for consent to subcontracts and for review, evaluation, and approval of contractors' purchasing systems.

SUBPART 44.1—GENERAL

44.101 Definitions.

"Approved purchasing system" means a contractor's purchasing system that has been reviewed and approved in accordance with this part.

"Consent to subcontract" means the contracting officer's written consent for the prime contractor to enter into a particular subcontract.

"Contractor," as used in this part, means the total contractor organization or a separate entity of it, such as an affiliate, division, or plant, that performs its own purchasing.

"Contractor purchasing system review (CPSR)" means the complete evaluation of a contractor's purchasing of material and services, subcontracting, and subcontract management from development of the requirement through completion of subcontract performance.

"Facilities" (see 45.301).

"Subcontract," as used in this part, means any contract as defined in Subpart 2.1 entered into by a subcontractor to furnish supplies or services for performance of a prime contract or a subcontract. It includes but is not limited to purchase orders, and changes and modifications to purchase orders.

"Subcontractor," as used in this part, means any supplier, distributor, vendor, or firm that furnishes supplies or services to or for a prime contractor or another subcontractor.

44.102 Policy.

(a) Consent to subcontracts is required under 44.201 when the subcontract work is complex, the dollar value is substantial, or the Government's interest is not adequately protected by competition and the type of prime contract or subcontract.

(b) Consent requirements may be waived when the contractor's purchasing system has been reviewed and approved in accordance with Subpart 44.3.

SUBPART 44.2—CONSENT TO SUBCONTRACTS

44.201 Consent requirements.

44.201-1 Fixed-price prime contracts.

(a) Consent to subcontracts is not required under prime contracts that are firm-fixed-price or fixed-price with economic price adjustment provisions. (See paragraph (c) below for unpriced modifications.)

(b) If the contractor has an approved purchasing system, consent to subcontracts is not required under other fixed-price prime contracts, except for any subcontracts selected for special surveillance. (See 44.205).

(c) If the contractor does not have an approved purchasing system, consent to the subcontracts specified in paragraph (d) below is required—

(1) Under fixed-price incentive and fixed-price redeterminable prime contracts; and

(2) Under prime contracts that are firm-fixed-price or fixed-price with economic price adjustment provisions, only when a new subcontract results from an unpriced modification to the prime contract.

(d) Under prime contracts required to include the clause at 52.244-1, Subcontracts (Fixed-Price Contracts), consent is required under paragraph (c) above for any subcontract that is—

(1) To be a cost-reimbursement, time-and-materials, or labor-hour contract estimated to be over $25,000, including any fee;

(2) Estimated to be over $100,000 (or less if the contract clause has been modified as permitted by its preface); or

(3) One of a number of subcontracts, under the prime contract, with a single subcontractor for the same or related supplies or services, which in the aggregate are estimated to be over $100,000 (or less, if the contract clause has been modified as permitted by its preface).

44.201-2 Cost-reimbursement and letter prime contracts.

(a) Consent is required under cost-reimbursement and letter prime contracts (except facilities contracts) for subcontracts (1) for fabrication, purchase, rental, installation, or other acquisition of special test equipment valued at more than $10,000 or of any items of facilities, or (2) that have experimental, developmental, or research work as one of their purposes.

(b) If the contractor does not have an approved purchasing system, consent is also required, under cost-reimbursement and letter prime contracts for (1) cost-reimbursement, time-and-materials, or labor-hour sub-

contracts and (2) fixed-price subcontracts that exceed either $25,000 or 5 percent of the total estimated cost of the prime contract; except that for DoD, Coast Guard, and NASA, the amounts shall be the greater of the small purchase limitation in Part 13 or 5 percent of the total estimated cost of the prime contract.

(c) If the contractor has an approved purchasing system, consent is not required for the subcontracts identified in paragraph (b) above, but advance notification is still required by 10 U.S.C. 2306(e) or 41 U.S.C 254(b).

(d) In contracts for acquisition of major systems, subsystems, or their components (see Part 34), consent is required for the subcontracts identified in paragraph (b) above, even though the contractor has an approved purchasing system.

44.201-3 Other prime contracts.

Except for purchase of raw material or commercial stock items, consent is required for all subcontracts under time-and-material contracts. Consent is required for subcontracts under prime contracts for—

(a) Architect-engineer services; and

(b) Mortuary services, refuse service, or shipment and storage of personal property, when an agency requires prior approval of subcontractors' facilities.

44.201-4 Contractor use of Government sources.

The contracting officer's written authorization for the contractor to purchase from Government sources (see Part 51) constitutes consent.

44.202 Contracting officer's evaluation.

44.202-1 Responsibilities.

(a) The cognizant administrative contracting officer (ACO) is responsible for consent to subcontracts, except when the contracting officer retains the contract for administration or withholds the consent responsibility from delegation to the ACO. In such cases, the contract administration office should assist the contracting office in its evaluation as requested.

(b) The responsible contracting officer shall—

(1) Promptly evaluate the contractor's requests for consent to subcontract;

(2) Obtain assistance in the evaluation from subcontracting, audit, pricing, technical, or other specialists as necessary; and

(3) Notify the contractor in writing of consent or the withholding of consent, including any changes or corrections required.

44.202-2 Considerations.

(a) The contracting officer responsible for consent shall review the request and supporting data and consider the following:

(1) Is the decision to subcontract consistent with the contractor's approved make-or-buy program, if any (see Subpart 15.7)?

(2) Is the subcontract for special test equipment or facilities that are available from Government sources (see Subpart 45.3)?

(3) Is the selection of the particular supplies, equipment, or services technically justified?

(4) Has the contractor complied with the prime contract requirements regarding labor surplus area or small business subcontracting, including, if applicable, its plan for subcontracting with small business concerns and small disadvantaged business concerns (see Part 19)?

(5) Was adequate price competition obtained or its absence properly justified?

(6) Did the contractor adequately assess and dispose of subcontractors' alternate proposals, if offered?

(7) Does the contractor have a sound basis for selecting and determining the responsibility of the particular subcontractor?

(8) Has the contractor performed adequate cost or price analysis or price comparisons and obtained accurate, complete, and current cost or pricing data, including any required certifications?

(9) Is the proposed subcontract type appropriate for the risks involved and consistent with current policy?

(10) Has adequate consideration been obtained for any proposed subcontract that will involve the use of Government-furnished facilities?

(11) Has the contractor adequately and reasonably translated prime contract technical requirements into subcontract requirements?

(12) Does the prime contractor comply with applicable cost accounting standards for awarding the subcontract?

(13) Is the proposed subcontractor on the Consolidated List of Debarred, Suspended, and Ineligible Contractors (see Subpart 9.4)?

(b) Particularly careful and thorough consideration under paragraph (a) above is necessary when—

(1) The prime contractor's purchasing system or performance is inadequate;

(2) Close working relationships or ownership affiliations between the prime and subcontractor may preclude free competition or result in higher prices;

(3) Subcontracts are proposed for award on a noncompetitive basis, at prices that appear unreasonable, or at prices higher than those offered to the Government in comparable circumstances; or

(4) Subcontracts are proposed on a cost-reimbursement, time-and-materials, or labor-hour basis.

44.203 Consent limitations.

(a) The contracting officer's consent to a subcontract or approval of the contractor's purchasing system does not constitute a determination of the acceptability of the subcontract terms or price, or of the allowability of costs, *unless the consent* or approval specifies otherwise.

(b) Contracting officers shall not consent to—

(1) Cost-reimbursement subcontracts if the fee exceeds the fee limitations of 16.301-3;

(2) Subcontracts providing for payment on a cost-plus-a-percentage-of-cost basis;

(3) Subcontracts obligating the contracting officer to deal directly with the subcontractor;

(4) Subcontracts that make the results of arbitration, judicial determination, or voluntary settlement between the prime contractor and subcontractor binding on the Government; or

(5) Repetitive or unduly protracted use of cost-reimbursement, time-and-materials, or labor-hour subcontracts (contracting officers should follow the principles of 16.103(c)).

(c) Contracting officers should not refuse consent to a subcontract merely because it contains a clause giving the subcontractor the right of indirect appeal to an agency board of contract appeals if the subcontractor is affected by a dispute between the Government and the prime contractor. Indirect appeal means assertion by the subcontractor of the prime contractor's right to appeal or the prosecution of an appeal by the prime contractor on the subcontractor's behalf. The clause may also provide that the prime contractor and subcontractor shall be equally bound by the contracting officer's or board's decision. The clause may not attempt to obligate the contracting officer or the appeals board to decide questions that do not arise between the Government and the prime contractor or that are not cognizable under the clause at 52.233-1, Disputes.

44.204 Contract clauses.

(a) *Fixed-price contracts.* (1) Except as specified in (a)(2) below, the contracting officer—

(i) Shall insert the clause at 52.244-1, Subcontracts (Fixed-Price Contracts), in solicitations and contracts when a fixed-price contract is contemplated and the contract amount is expected to exceed $500,000; and

(ii) May insert the clause in solicitations and contracts when a fixed-price contract is contemplated and the contract amount is not expected to exceed $500,000, if the contracting officer determines that its use will be in the Government's interest.

(2) The clause shall not be used (i) in solicitations and contracts for mortuary services, refuse services, or shipment and storage of personal property, when an agency prescribed clause on approval of subcontractors' facilities is required, or (ii) in architect-engineer contracts.

(3) If the contracting officer elects to delete the requirement for advance notification of, or consent to, any subcontracts that were evaluated during negotiations (this election is not authorized for acquisition of major systems and subsystems or their components), the contracting officer shall use the clause with its Alternate I. See also 44.205.

(b) *Cost-reimbursement and letter contracts.* The contracting officer shall insert the clause at 52.244-2, Subcontracts (Cost-Reimbursement and Letter Contracts), in solicitations and contracts when a cost-reimbursement or letter contract is contemplated. If the contracting office is in DoD, the Coast Guard, or NASA, the contracting officer shall use the clause with its Alternate I. See also 44.205.

(c) *Time-and-materials and labor-hour contracts.* The contracting officer shall insert the clause at 52.244-3, Subcontracts (Time-and-Materials and Labor-Hour Contracts), in solicitations and contracts when a time-and-materials or labor-hour contract is contemplated.

(d) *Architect-engineer contracts.* The contracting officer shall insert the clause at 52.244-4, Subcontractors and Outside Associates and Consultants, in fixed-price architect-engineer contracts.

(e) *Competition in subcontracting.* The contracting officer shall, when contracting by negotiation, insert the clause at 52.244-5, Competition in Subcontracting, in solicitations and contracts when the contract amount is expected to exceed the small purchase limitation in Part 13, unless—

(1) A firm-fixed-price contract, awarded on the basis of adequate price competition or whose prices are set by law or regulation, is contemplated; or

(2) A contract of the type and/or purpose identified in paragraphs (c) and (d) above is contemplated.

44.205 Special surveillance.

In exceptional circumstances, contracting officers may select subcontracts requiring extraordinary Government surveillance for special surveillance, by specifying the selected subcontracts in the prime contract Schedule.

SUBPART 44.3—CONTRACTORS' PURCHASING SYSTEMS REVIEWS

44.301 Objective.

The objective of a contractor purchasing system review (CPSR) is to evaluate the efficiency and effectiveness with which the contractor spends Government funds and complies with Government policy when subcontracting. The review provides the administrative contracting officer (ACO) a basis for granting, withholding, or withdrawing approval of the contractor's purchasing system.

44.302 Requirements.

(a) Except as provided in paragraph (b) below, a CPSR shall be conducted for each contractor whose sales to the Government, using other than sealed bid procedures, are expected to exceed $10 million during the next 12 months. Such sales include those represented by prime contracts, subcontracts under Government prime contracts, and modifications (except when the negotiated price is based on established catalog or market prices of commercial items sold in substantial quantities to the general public, or is set by law or

regulation). Generally, a CPSR is not performed for a specific contract. The head of the agency responsible for contract administration may raise or lower the $10 million review level if such action is considered to be in the Government's best interest.

(b) A CPSR shall be conducted by the cognizant contract administration agency (see Subpart 42.3) at least every 3 years for contractors that continue to meet the requirements of paragraph (a) above. This review may be accomplished at one time or on a continuing basis. A more frequent review cycle may be established if warranted (e.g., when resident surveillance personnel are not assigned), and special reviews may be conducted when information reveals a deficiency or major change in the contractor's purchasing system.

44.303 Extent of review.

A CPSR requires a complete evaluation of the contractor's purchasing system. The considerations listed in 44.202-2 for consent evaluations of particular subcontracts shall also be used to evaluate the contractor's purchasing system, including the contractor's policies, procedures, and performance under that system. Special attention shall be given to—

(a) The degree of price competition obtained;

(b) Pricing policies and techniques, including methods of obtaining accurate, complete, and current cost or pricing data and certification as required;

(c) Methods of evaluating subcontractors' responsibility;

(d) Treatment accorded affiliates and other concerns having close working arrangements with the contractor;

(e) Policies and procedures pertaining to labor surplus area concerns and small business concerns, including small disadvantaged business concerns;

(f) Planning, award, and postaward management of major subcontract programs;

(g) Compliance with Cost Accounting Standards in awarding subcontracts;

(h) Appropriateness of types of contracts used (see 16.103); and

(i) Management control systems, including internal audit procedures, to administer progress payments to subcontractors.

44.304 Surveillance.

(a) In the period between complete CPSR's, the ACO shall maintain a sufficient level of surveillance to assure that the contractor is effectively managing its purchasing program. The ACO shall make a determination annually to (1) continue approval based on surveillance or (2) request a CPSR or special review as a basis for continuing or withdrawing approval.

(b) Surveillance shall be accomplished in accordance with a plan developed by the ACO with the assistance of subcontracting, audit, pricing, technical, or other specialists as necessary. The plan shall cover pertinent phases of a contractor's purchasing system (preaward, postaward, performance, and contract completion) and pertinent operations that affect the contractor's purchasing and subcontracting. The plan shall also provide for reviewing the effectiveness of the contractor's corrective actions taken as a result of previous Government recommendations. Duplicative reviews of the same areas by CPSR and other surveillance monitors shall be avoided.

44.305 Granting, withholding, or withdrawing approval.

44.305-1 Responsibilities.

(a) The cognizant ACO is responsible for granting, withholding, or withdrawing approval of a contractor's purchasing system. The ACO shall—

(1) Approve a purchasing system only after a CPSR discloses that the contractor's purchasing policies and practices are efficient and provide adequate protection of the Government's interests;

(2) Between CPSR's, determine annually whether there are any significant deviations from approved policies and practices that would indicate a need for a special review or new CPSR to decide whether or not to withdraw approval; and

(3) Promptly notify the contractor in writing of the granting, withholding, or withdrawing of approval.

(b) If, upon expiration of approval of the contractor's purchasing system, the ACO has not specifically withheld, continued, or withdrawn approval, the approval shall continue for another 90 days. Any further extension requires written approval at least one level higher than the ACO.

44.305-2 Notification.

(a) The notification granting initial system approval or continuation of system approval shall include—

(1) Identification of the plant or plants where the review was conducted;

(2) The effective date of approval and period for which approval is valid;

(3) A statement that system approval—

(i) Applies to all Federal Government contracts at that plant to the extent that cross-servicing arrangments exist;

(ii) Waives the contractual requirement for advance notification in fixed-price contracts, but not for cost-reimbursement contracts;

(iii) Waives the contractual requirement for consent to subcontracts in fixed-price contracts and for specified subcontracts in cost-reimbursement contracts but not for those subcontracts, if any, selected for special surveillance and identified in the contract Schedule;

(iv) Shall automatically terminate at the end of the approval period (or approval period as extended);

(v) Shall automatically terminate when any significant change occurs in the system unless approved by the ACO; and

(vi) May be withdrawn at any time at the ACO's discretion.

(b) In exceptional circumstances, consent to certain subcontracts or classes of subcontracts may be required even though the contractor's purchasing system has been approved. The system approval notification shall identify the class or classes of subcontracts requiring consent. Reasons for selecting the subcontracts include the fact that a CPSR or continuing surveillance has revealed sufficient weaknesses in a particular area of subcontracting to warrant special attention by the ACO.

(c) When recommendations are made for improvement of an approved system, the contractor shall be requested to reply within 15 days with a position regarding the recommendations.

44.305-3 Withholding or withdrawing approval.

(a) The ACO shall withhold or withdraw approval of a contractor's purchasing system when there are major weaknesses or when the contractor is unable to provide sufficient information upon which to make an affirmative determination. The ACO may withdraw approval at any time on the basis of a determination that there has been a deterioration of the contractor's purchasing system or to protect the Government's interest. Approval shall be withheld or withdrawn when there is a recurring noncompliance with requirements, including but not limited to—

(1) Cost or pricing data (see 15.804);

(2) Implementation of cost accounting standards (see Part 30);

(3) Advance notification as required by the clauses prescribed in 44.204; or

(4) Small business subcontracting (see Subpart 19.7).

(b) When approval of the contractor's purchasing system is withheld or withdrawn, the ACO shall within 10 days after completing the in-plant review (1) inform the contractor in writing, (2) specify the deficiencies that must be corrected to qualify the system for approval, and (3) request the contractor to furnish within 15 days a plan for accomplishing the necessary actions. If the plan is accepted, the ACO shall make a follow-up review as soon as the contractor notifies the ACO that the deficiencies have been corrected.

44.306 Disclosure of approval status.

Upon request, the ACO may inform a contractor that the purchasing system of a proposed subconcontractor has been approved, but shall caution that the Government will not keep the contractor advised of any changes in the approval status. If the proposed subcontractor's purchasing system has not been examined or approved, the contractor shall be so advised.

44.307 Reports.

The ACO shall distribute copies of CPSR reports; notifications granting, continuing, withholding, or withdrawing system approval; and Government recommendations for improvement of an approved system, including the contractor's response, to at least—

(a) The cognizant contract audit office;

(b) Activities prescribed by the cognizant agency; and

(c) The contractor (except that furnishing copies of the contractor's response is optional).

52.244-1 Subcontracts (Fixed-Price Contracts).

As prescribed in 44.204(a), insert the following clause:

SUBCONTRACTS (FIXED-PRICE CONTRACTS) (JAN 1986)

(a) This clause does not apply to firm-fixed-price contracts and fixed- price contracts with economic price adjustment. However, it does apply to subcontracts resulting from unpriced modifications to such contracts.

(b) "Subcontract," as used in this clause, includes but is not limited to purchase orders, and changes and modifications to purchase orders. The Contractor shall notify the Contracting Officer reasonably in advance of entering into any subcontract if the Contractor does not have an approved purchasing system and if the subcontract—

(1) Is to be a cost-reimbursement, time-and-materials, or labor-hour contract estimated to exceed $25,000 including any fee;

(2) Is proposed to exceed $100,000; or

(3) Is one of a number of subcontracts with a single subcontractor, under this contract, for the same or related supplies or services, that in the aggregate are expected to exceed $100,000.

(c) The advance notification required by paragraph (b) above shall include—

(1) A description of the supplies or services to be subcontracted;

(2) Identification of the type of subcontract to be used;

(3) Identification of the proposed subcontractor and an explanation of why and how the proposed subcontractor was selected, including the competition obtained;

(4) The proposed subcontract price and the Contractor's cost or price analysis;

(5) The subcontractor's current, complete, and accurate cost or pricing data and Certificate of Current Cost or Pricing Data, if required by other contract provisions;

(6) The subcontractor's Disclosure Statement or Certificate relating to Cost Accounting Standards when such data are required by other provisions of this contract; and

(7) A negotiation memorandum reflecting—

(i) The principal elements of the subcontract price negotiations;

(ii) The most significant considerations controlling establishment of initial or revised prices;

(iii) The reason cost or pricing data were or were not required;

(iv) The extent, if any, to which the Contractor did not rely on the subcontractor's cost or pricing data in determining the price objective and in negotiating the final price;

(v) The extent, if any, to which it was recog-

nized in the negotiation that the subcontractor's cost or pricing data were not accurate, complete, or current; the action taken by the Contractor and subcontractor; and the effect of any such defective data on the total price negotiated;

(vi) The reasons for any significant difference between the Contractor's price objective and the price negotiated; and

(vii) A complete explanation of the incentive fee or profit plan when incentives are used. The explanation shall identify each critical performance element, management decisions used to quantify each incentive element, reasons for the incentives, and a summary of all trade-off possibilities considered.

(d) The Contractor shall obtain the Contracting Officer's written consent before placing any subcontract for which advance notification is required under paragraph (b) above. However, the Contracting Officer may ratify in writing any such subcontract. Ratification shall constitute the consent of the Contracting Officer.

(e) Even if the Contractor's purchasing system has been approved, the Contractor shall obtain the Contracting Officer's written consent before placing subcontracts that have been selected for special surveillance and so identified in the Schedule of this contract.

(f) Unless the consent or approval specifically provides otherwise, neither consent by the Contracting Officer to any subcontract nor approval of the Contractor's purchasing system shall constitute a determination (1) of the acceptability of any subcontract terms or conditions, (2) of the acceptability of any subcontract price or of any amount paid under any subcontract, or (3) to relieve the Contractor of any responsibility for performing this contract.

(g) No subcontract placed under this contract shall provide for payment on a cost-plus-a-percentage-of-cost basis, and any fee payable under cost-reimbursement subcontracts shall not exceed the fee limitations in subsection 15.903(d) of the Federal Acquisition Regulation (FAR).

(h) The Government reserves the right to review the Contractor's purchasing system as set forth in FAR Subpart 44.3.

(End of clause)

Alternate I (APR 1984). If the Contracting Officer elects to delete the requirement for advance notification of, or consent to, any subcontracts that were evaluated during negotiations (this election is not authorized for acquisition of major systems and subsystems or their components), add the following paragraph (i) to the basic clause:

(i) Paragraphs (b) and (c) of this clause do not apply to the following subcontracts, which were evaluated during negotiations: *[list subcontracts]*

(R 23-201.1(b)(ii) 1977 APR)

52.244-2 Subcontracts Under Cost-Reimbursement and Letter Contracts.

As prescribed in 44.204(b), insert the following clause:

SUBCONTRACTS (COST-REIMBURSEMENT AND LETTER CONTRACTS) (JUL 1985)

(a) "Subcontract," as used in this clause, includes but is not limited to purchase orders, and changes and modifications to purchase orders. The Contractor shall notify the Contracting Officer reasonably in advance of entering into any subcontract if—

(1) The proposed subcontract is of the cost-reimbursement, time-and-materials, or labor-hour type;

(2) The proposed subcontract is fixed-price and exceeds either $25,000 or 5 percent of the total estimated cost of this contract;

(3) The proposed subcontract has experimental, developmental, or research work as one of its purposes; or

(4) This contract is not a facilities contract and the proposed subcontract provides for the fabrication, purchase, rental, installation, or other acquisition of special test equipment valued in excess of $10,000 or of any items of facilities.

(b) (1) In the case of a proposed subcontract that (i) is of the cost-reimbursement, time-and-materials, or labor-hour type and is estimated to exceed $10,000, including any fee, (ii) is proposed to exceed $100,000, or (iii) is one of a number of subcontracts with a single subcontractor, under this contract, for the same or related supplies or services that, in the aggregate, are expected to exceed $100,000, the advance notification required by paragraph (a) above shall include the information specified in subparagraph (2) below.

(2) (i) A description of the supplies or services to be subcontracted.

(ii) Identification of the type of subcontract to be used.

(iii) Identification of the proposed subcontractor and an explanation of why and how the proposed subcontractor was selected, including the competition obtained.

(iv) The proposed subcontract price and the Contractor's cost or price analysis.

(v) The subcontractor's current, complete, and accurate cost or pricing data and Certificate of Current Cost or Pricing Data, if required by other contract provisions.

(vi) The subcontractor's Disclosure Statement or Certificate relating to Cost Accounting Standards when such data are required by other provisions of this contract.

(vii) A negotiation memorandum reflecting—

(A) The principal elements of the subcontract price negotiations;

(B) The most significant considerations controlling establishment of initial or revised prices;

(C) The reason cost or pricing data were or were not required;

(D) The extent, if any, to which the Contractor did not rely on the subcontractor's cost or pricing data in determining the price objective and in negotiating the final price;

(E) The extent to which it was recognized in the negotiation that the subcontractor's cost or pricing data were not accurate, complete, or current; the action taken by the Contractor and the subcontractor; and the effect of any such defective data on the total price negotiated;

(F) The reasons for any significant difference between the Contractor's price objective and the price negotiated; and

(G) A complete explanation of the incentive fee or profit plan when incentives are used. The explanation shall identify each critical performance element, management decisions used to quantify each incentive element, reasons for the incentives, and a summary of all trade-off possibilities considered.

(c) The Contractor shall obtain the Contracting Officer's written consent before placing any subcontract for which advance notification is requred under paragraph (a) above. However, the Contracting Officer may ratify in writing any such subcontract. Ratification shall constitute the consent of the Contracting Officer.

(d) If the Contractor has an approved purchasing system and the subcontract is within the scope of such approval, the Contractor may enter into the subcontracts described in subparagraphs (a)(1) and (a)(2) above without the consent of the Contracting Officer, unless this contract is for the acquisition of major systems, subsystems, or their components.

(e) Even if the Contractor's purchasing system has been approved, the Contractor shall obtain the Contracting Officer's written consent before placing subcontracts that have been selected for special surveillance and identified in the Schedule of this contract.

(f) Unless the consent or approval specifically provides otherwise, neither consent by the Contracting Officer to any subcontract nor approval of the Contractor's purchasing system shall constitute a determination (1) of the acceptability of any subcontract terms or conditions, (2) of the allowability of any cost under this contract, or (3) to relieve the Contractor of any responsibility for performing this contract.

(g) No subcontract placed under this contract shall provide for payment on a cost-plus-a-percentage-of-cost basis, and any fee payable under cost-reimbursement type subcontracts shall not exceed the fee limitations in paragraph 15.903(d) of the Federal Acquisition Regulation (FAR).

(h) The Contractor shall give the Contracting Officer immediate written notice of any action or suit filed and prompt notice of any claim made against the Contractor by any subcontractor or vendor that, in the opinion of the Contractor, may result in litigation related in any way to this contract, with respect to which the Contractor may be entitled to reimbursement from the Government.

(i) (1) The Contractor shall insert in each price redetermination or incentive price revision subcontract under this contract the substance of the paragraph "Quarterly limitation on payments statement" of the clause at 52.216-5, Price Redetermination—Prospective, 52.216-6, Price Redetermination—Retroactive, 52.216-16, Incentive Price Revision—Firm Target, or 52.216-17, Incentive Price Revision—Successive Targets, as appropriate, modified in accordance with the paragraph entitled "Subcontracts" of that clause.

(2) Additionally, the Contractor shall include in each cost-reimbursement subcontract under this contract a requirement that the subcontractor insert the substance of the appropriate modified subparagraph referred to in subparagraph (1) above in each lower tier price redetermination or incentive price revision subcontract under that subcontract.

(j) To facilitate small business participation in subcontracting, the Contractor agrees to provide progress payments on subcontracts under this contract that are fixed-price subcontracts with small business concerns in conformity with the standards for customary progress payments stated in FAR 32.502-1 and 32.504(f), as in effect on the date of this contract. The Contractor further agrees that the need for such progress payments will not be considered a handicap or adverse factor in the award of subcontracts.

(k) The Government reserves the right to review the Contractor's purchasing system as set forth in FAR Subpart 44.3.

(End of clause)

Alternate I (APR 1985). If the contracting office is in DoD, the Coast Guard, or NASA, substitute the following subparagraph (a)(2) for subparagraph (a)(2) of the basic clause:

(a)(2) The proposed subcontract is fixed-price and exceeds the greater of (i) the small purchase limitation in Part 13 of the Federal Acquisition Regulation or (ii) 5 percent of the total estimated cost of this contract.

52.244-3 Subcontracts Under Time-and-Materials and Labor-Hour Contracts.

As prescribed in 44.204(c), insert the following clause:

SUBCONTRACTS (TIME-AND-MATERIALS AND LABOR-HOUR CONTRACTS) (APR 1985)

(a) "Subcontract," as used in this clause, includes but

is not limited to purchase orders, and changes and modifications to purchase orders. The Contractor shall obtain the Contracting Officer's written consent before placing any subcontract for furnishing any of the work called for in this contract, except for purchase of raw material or commercial stock items.

(b) No subcontract placed under this contract shall provide for payment on a cost-plus-a-percentage-of-cost basis, and any fee payable under cost-reimbursement subcontracts shall not exceed the fee limitations in subsection 16.301-4 of the Federal Acquisition Regulation (FAR).

(c) The Government reserves the right to review the Contractor's purchasing system as set forth in FAR Subpart 44.3.

(d) Unless the consent or approval specifically provides otherwise, neither consent by the Contracting Officer to any subcontract nor approval of the Contractor's purchasing system shall constitute a determination (1) of the acceptability of any subcontract terms or conditions, (2) of the acceptability of any subcontract price or of any amount paid under any subcontract, or (3) to relieve the Contractor of any responsibility for performing this contract.

(End of clause)

(R 7-901.10 1979 MAR)

52.244-4 Subcontractors and Outside Associates and Consultants.

As prescribed in 44.204(d), insert the following clause in fixed-price architect-engineer contracts:

SUBCONTRACTORS AND OUTSIDE ASSOCIATES AND CONSULTANTS (APR 1984)

Any subcontractors and outside associates or consultants required by the Contractor in connection with the services covered by the contract will be limited to individuals or firms that were specifically identified and agreed to during negotiations. The Contractor shall obtain the Contracting Officer's written consent before making any substitution for these subcontractors, associates, or consultants.

(End of clause)

(SS 7-607.16 1965 JAN)

52.244-5 Competition in Subcontracting.

As prescribed in 44.204(e), when contracting by negotiation, insert the following clause in solicitations and contracts when the contract amount is expected to exceed the appropriate small purchase limitation in Part 13, unless –

(a) A firm-fixed-price contract, awarded on the basis of adequate price competition or whose prices are set by law or regulation, is contemplated; or

(b) A contract of the type and/or purpose identified in 44.204(c) and (d) is contemplated.

COMPETITION IN SUBCONTRACTING (APR 1984)

The Contractor shall select subcontractors (including suppliers) on a competitive basis to the maximum practical extent consistent with the objectives and requirements of the contract.

(End of clause)

(V 7-104.40 1962 APR)

(V 1-7.202-30)

(V 7-303.27)

(V 7-402.29)

(V 7-603.18)

(V 7-605.37)

(V 7-702.50)

(V 7-703.43)

(V 7-704.35)

(V 7-1703.5)

(V 7-1903.28)

(V 7-1909.23)

PART 44--SUBCONTRACTING POLICIES AND PROCEDURES
SUBPART 44.3--CONTRACTORS' PURCHASING SYSTEMS REVIEWS

44.301 Objective. This subpart sets forth the DoD requirements for conducting a contractor purchasing system review (CPSR) under the direction of a purchasing system analyst (PSA). When deemed necessary, Contractor Purchasing System Review Boards may be established in accordance with Departmental procedures. If no board is to be convened, the report shall be forwarded directly to the ACO by the CPSR team captain. If it is determined that a review board is necessary, the report of the CPSR team shall be reviewed and evaluated by the board, which shall make appropriate recommendations to the ACO.

44.302 Requirements.

(b)(1) Initial Review. An initial review is a complete, intensive, first-time analysis of a contractor's purchasing system.

(2) Subsequent Review. A subsequent review is an analysis of a contractor's purchasing system, performed to validate the adequacy of the system.

(i) Plants in which there is a full-time resident PSA shall receive, after an initial review, continuing surveillance equivalent to a subsequent review on an annual basis or continuing surveillance with subsequent reviews at 3-year intervals.

(ii) Plants in which there is no resident PSA shall receive, after initial review, surveillance through on-site visits (44.304), and a subsequent review in alternate years. The contracting officer may call for a subsequent review prior to the regularly scheduled review if circumstances indicate the need.

(3) Special Reviews. A special review is an investigation of specific weaknesses identified in any contractor's purchasing system, using the same techniques followed in performing an initial or subsequent review. The ACO, or the PSA, with the concurrence of the ACO, may initiate special review of any contractor's purchasing system in connection with deficiencies revealed as a result of:

(i) the initial or subsequent review, or continuing indepth surveillance;

(ii) the review of subcontracts submitted under the notification and consent to subcontract requirements of contract clauses;

(iii) major changes in the contractor's purchasing policies, procedures, or key personnel;

(iv) changes in plant workload or type of work; or

(v) information provided by Government personnel.

In conducting special reviews, the same criteria used in initial or subsequent reviews shall be applied to the area being examined. The summary report format will be used as appropriate.

(4) Followup Review. A followup review is an investigation performed when a contractor's purchasing system approval is withheld or withdrawn, to determine whether a contractor has implemented the

recommendations of the ACO and corrected the deficiencies revealed by any purchasing system review. The techniques used in making an initial or subsequent review are employed in the followup review. If approval of a contractor's purchasing system is withheld or withdrawn, a followup review shall be made as soon as evidence is received from the contractor that the factors leading to the action have been corrected. Whether this followup review consists of a complete reexamination of the contractor's purchasing system or is confined to the areas found deficient shall be a matter of judgment and will depend on the time lapse between the notice to the contractor of withholding or withdrawal of approval and the followup review. The summary report format will be used as appropriate.

44.303 Extent of Review. Supplement 1 contains additional guidance for conducting CPSR's on Defense Contractors.

44.304 Surveillance.

(a) Each Military Department and the Defense Logistics Agency will establish controls to assure maintenance of a viable surveillance program.

(b) The surveillance plan shall specifically include the contractor response for corrective action to the recommendations made by the ACO as a result of an initial or indepth subsequent purchasing system review and the Government's planned surveillance tests of the contractor's corrective implementation. The surveillance plan shall provide procedures for informing the contractor of surveillance findings and related recommendations; for followup, as necessary, to effect recommended improvements; and when warranted by the findings, for rescinding approval of the contractor's purchasing system. The contractor must make available the necessary procedures and data to permit adequate surveillance.

(1) The surveillance plan shall encompass pertinent phases of the contractor's purchasing system (Preaward/Postaward/Performance/Contract Completion) and pertinent operations which impact the contractor's purchasing and subcontracting. As considered necessary, surveillance shall include:

(i) determination and limitation of requirements;

(ii) advance planning (market testing, source development, performance evaluations, program objectives, make-or-buy);

(iii) solicitation of proposals (development of solicitations, statement of work, specifications/drawings, facility surveys, financial analysis, preaward audits, terms and conditions, selection of contract type, establishing a competitive base, socio-economic consideration, bidders lists, presolicitation and indoctrination of potential bidders);

(iv) proposal evaluations (cost, technical, and management considerations);

(v) source selection (restrictive clauses, flowdown of prime contract provisions, compliance with Public Law 87-653, "Truth in Negotiations Act," compliance with Public Law 91-379, "Cost Accounting Standards," cost/price analysis/assist audits and cost studies, progress payments to subcontractors, changes in technical content of statement of work, factfinding and bidders conference);

(vi) provisioning, management influence and overriding consideration, documentation, compliance with FAR 9.104-4 and other provisions of this Supplement concerning Subcontractor Responsibility;

(vii) management approvals;

(viii) advance notification and consent requirements;

(ix) early definition (TWX and letter contracts);

(x) change control (timely and effective action);

(xi) engineering;

(xii) schedules;

(xiii) production;

(xiv) material control;

(xv) quality control and quality assurance;

(xvi) management reporting (advance payments, progress payments, cost performance, funding requirements, discounts, milestone and progress reports);

(xvii) management support (residencies, secondary administration, buyer control of commitments, buyer's role, subcontract management, subcontract modification, expediting, transportation, subcontractor system surveillance);

(xviii) contract completion (termination partial or complete, stopwork orders, default actions, excusable delays);

(xix) closeout actions;

(xx) postaward audits; and

(xxi) performance evaluation and reports (thorough review of all areas, including documentation for future business).

(2) The plan shall give appropriate consideration to the data furnished by the contractor when providing the required advance notification of intent to place certain subcontracts.

(3) Surveillance tests that require audit effort should be accomplished for the ACO by the contract auditor in conjunction with other audit duties.

(4) Certain subcontractors may require additional surveillance because of the emphasis in the flowdown of system acquisition policies in subcontracts, with particular concern for subcontractor cost, schedule, and technical performance. The contracting officer, the PSA, the review team, and/or subcontract management personnel may request assistance of the contract administration office having cognizance over the subcontractor to provide supplementary information as a means of verifying the information obtained from the contractor's records and, if needed, the request will call for a complete report on the subcontractor's purchasing system.

44.305 Granting, Withholding, or Withdrawing Approval. An exit conference shall be held with the contractor at completion of the in-plant review. At that time, the contractor should be given the review team's recommendations signed by the ACO. The contractor shall be requested to furnish his plan for accomplishing the necessary actions within 15 days.

44.305-2 Notification.

(c) If at any time other than during a CPSR, recommendations are made for improvement of an approved system, the contractor shall be requested to furnish within 15 days of such notification a concurrence or position with respect to the recommendations.

44.307 Reports. After receipt of the complete report (Parts I and II), the ACO, within 5 days, shall review and evaluate the report, prepare a letter to the contractor stating the status of the purchasing system, and provide copies of the report and the letter to those described in FAR 44.307 and such others as approved by the ACO. One copy of the summary report (Part I only) shall be sent to a contracting office when requested. Also, where there is a resident PSA assigned to the contractor's plant, the cognizant CAS organization has the option of preparing only a summary report, which shall be distributed in accordance with FAR 44.307. A copy of the ACO's letter to the contractor, setting forth the status of the purchasing system, shall be attached to the summary report.

SUBCONTRACTING MADE EASY

Consent for Subcontracts — Getting the ACO's 'A-OK'

by Calvin Brusman

One of the clauses included in all U.S. government prime contracts but rarely found in commercial contracting is the Subcontracts Clause. Its requirements vary considerably for the different types of prime contracts.

In essence, the clause requires the prime contractor to give advance notification and written justification for procurements to the government's administrative contracting officer (ACO). Before awarding the order, the ACO must provide written consent. If the contractor's purchasing system is government approved, certain requirements of the Subcontracts Clause are waived. The clause also relieves the contracting officer from determining the acceptability of any subcontract terms, conditions, and prices.

The DAR/FAR Subcontracts Consent Matrix (Table I) lists the DAR/FAR Subcontracts Clause requirements for various prime contracts and for subcontracts to be awarded under the prime. It does not include subcontracts under FAR facilities contracts because the FAR does not identify subcontracts consent requirements applicable to facilities contracts in its "Consent to Subcontracts" provisions. Otherwise, the DAR and FAR subcontracts consent requirements are basically the same.



ABOUT THE AUTHOR

Calvin Brusman is currently the Subcontracts Manager for the Defense Systems Division of Computer Sciences Corp. He has held positions in contracts/subcontracts with General Electric Co., UNIVAC Div. of Sperry Corp., and the Princeton Plasma Physics Laboratory and is president of the Greater Philadelphia Chapter of NCMA.

In a significant procedural change from past policy, the FAR states that under fixed price prime contracts the Subcontracts Clause need only be included in prime contracts of $500,000 or more. However, the clause may be included in fixed price prime contracts of lesser amounts if the contracting officer determines it would be in the government's interest.

The specific items of the DAR/FAR Subcontracts Clause that constitute "advance notification" include the following:

- A description of the supplies/services to be procured.
- Identification of the proposed subcontractor.
- An abstract of the bidders' price quotations.
- The proposed subcontract price and justification/evaluation of same.
- The proposed subcontractor's cost or pricing data and certification therefor, when required.
- Identification of the type of subcontract proposed.
- A memorandum of the principal elements of negotiation between the prime and subcontractor.
- The basis for vendor selection, including sole source or single source justification, as applicable.

While not specifically stated in the Subcontracts Clause, the contractor must screen his inhouse government property and the Excess Automation Equipment Bulletins put out by other federal agencies for available supplies before procuring the same from a vendor.

To save time when requesting ACO consent, try using a standard form letter (Table II) which includes the required advance notification items. You could then attach written justification, as necessary, to substantiate and document items of advance notification.

Prime contractors unfamiliar with the DAR/FAR Subcontracts Clause requirements should set up specific procedures to ensure compliance with the clause. Its provisions, including the justification and substantiation necessary for compliance, are the essence of the government's subcontracting policy. Adherence to those requirements is very important since it is likely that the government, in reviewing the contractor's purchasing system, will closely check this area. □

(continued on page 22)

Continued from page 21

Table I.
DAR/FAR Subcontracts Consent Matrix

Requirements for Advance Notification, Written Justification and Prior ACO Consent

AN — Advance Notification
WJ — Written Justification
PC — Prior Consent[1]
* — Waived when within the scope of the contractor's purchasing system approval except when selected for special surveillance.
EOC — Equal Opportunity (Pre-Award) Clearance (see DAR 7-104.22/FAR 52.222-28)

Type of Subcontract	Type of Prime Contract			
	Fixed Price[2]	Cost Reimburse & Letter Type	T&M and Labor Hour	Facilities[3]
	DAR 23-201.1, 7-104.23; FAR 44.201-1, 52.244-1	DAR 23-201.2, 7-203.8, 7-402.8; FAR 44.201-2, 52.244-2	DAR 23-201.3, 7-901.10; FAR 44.201-3, 52.244-3	DAR 23-201.2(a)(3), 7-702.33, 7-703.25
A. Fixed Price				
1. All Fixed Price Subcontracts described below				
2. Subs for Experimental, Development, or Research effort regardless of value		AN PC		
3. Subs Over $25,000 or 5% of the Prime Contract		AN PC*		AN PC*
4. Subs Over $100,000	AN* WJ* PC*	AN WJ PC*		AN WJ PC*
5. Families of Subs expected to exceed $100,000	AN* WJ* PC*	AN WJ		AN WJ
6. Subs Over $1,000,000; also treat same as above/below	EOC	EOC	EOC	EOC
7. Any Item of Industrial Facilities regardless of value		AN PC		
8. Special Test Equipment Over $10,000		AN PC		
9. Written approval of all work, except raw material and commercial stock items			AN PC	
B. Cost Reimbursement, Time & Materials, Labor Hour				
1. All above type B Subcontracts and as described below		AN PC*		AN PC*
2. Subs for Experimental, Development, or Research effort regardless of value		AN PC		
3. Subs Over $10,000 (including fee)		AN WJ PC*		AN WJ PC*
4. Subs Over $25,000 (including fee)	AN* WJ* PC*			
5. Subs Over $100,000		AN WJ PC*		AN WJ PC*
6. Families of Subs expected to exceed $100,000		AN WJ		AN WJ
7. Subs Over $1,000,000; also treat same as above/below	EOC	EOC	EOC	EOC
8. Any Item of Industrial Facilities regardless of value		AN PC		
9. Special Test Equipment Over $10,000		AN PC		
10. Written approval of all work, except raw material and commercial stock items.			AN PC	

1. The contracting officer's written authorization to purchase from GSA supply sources constitutes consent.
2. Applicable only to FP Incentive, FP Redeterminable, and to unpriced modifications under Firm FP and FP with economic price adjustment.
3. Consent requirements not specified in the FAR "Consent to Subcontracts" provisions.

Table II.

Advance Notification, Written Justification and Prior ACO Consent

Date _____

(1) FROM: _____

(2) TO: _____

(3) SUBJECT:

☐ Advance Notification of Procurement
☐ Written Justification for Procurement

and request for

☐ Prior ACO Consent-Preliminary*
☐ Prior ACO Consent-Final

*Written justification to follow.

Contract No. _____ Type _____
Requisition No. _____ PO/SC No. _____

(4) VENDOR SELECTED AND ADDRESS:

_____

(5) TYPE PURCHASE ORDER/SUBCONTRACT:

☐ Fixed Price ☐ T&M/Labor Hour
☐ Cost Reimbursement
☐ Letter Type ☐ _____

(6) DESCRIPTION OF SUPPLIES/SERVICES:

_____

☐ Contractor has screened its/government's property files for availability of above supplies with negative results.

(7) BASIS FOR SELECTION:

☐ Technical Capability
☐ Fair and Reasonable Price
☐ Acceptable Delivery Schedule
☐ Low Competitive Bid
☐ Customer Preference
☐ Other: _____

(8) SOLE SOURCE/SINGLE SOURCE JUSTIFICATION:

☐ Only known source
☐ Supplies must be compatible with previously furnished equipment
☐ Supplies/services required are most reasonably and expeditiously obtained from original equipment supplier
☐ Exercise of a vendor option
☐ Continuation of vendor support services
☐ Prior satisfactory services at a fair and reasonable price
☐ Other: _____

(9) PRICE JUSTIFICATION:

☐ Catalog/market price of standard commercial item sold in substantial quantities to the general public
☐ Competitive Quotation (See below)
☐ Comparison of Similar Items (See below)
☐ Negotiated Price
☐ Certification of Price
☐ Buyer Discretion
☐ Other: _____

(10) REASON FOR SUBMISSION TO ACO FOR APPROVAL:

See box marked on attached matrix.

(11) WRITTEN JUSTIFICATION:

☐ Furnished herewith, as applicable
☐ To be supplied
☐ Not applicable

Written justification is required to be supplied in accordance with the applicable provision of the Prime Contract. (See matrix.)

(12) VENDORS SOLICITED:

	Name of Company	Item Description	Qty. Term	Unit Price	Total Price	Delivery
1.						
2.						
3.						
4.						
5.						

/s/ _____ Date _____
(Typed) _____
(Title) _____

ACO Preliminary Consent Granted _____ Date _____

ACO Final Consent Granted _____ Date _____

Subcontracting Made Easy

by Calvin Brusman

Standards of Conduct and Business Ethics for Buyers

In a recent letter the government advised defense contractors to increase the surveillance of their employees' relations with subcontractors in relation to subcontractor kickbacks. The letter stated that in the future, such monitoring of contractors would be done by means of the Contractor Purchasing System Review (CPSR) to determine whether the contractor's internal policies include the following safeguards:

- Published standards of conduct and business ethics policy for buyers;
- Approval by higher management of purchases exceeding $25,000 before the procurement is finalized;
- Periodic rotation of buyers' purchasing assignments;
- A management program to interview suppliers to determine if there have been any irregularities or incidents of questionable conduct by buyers;
- A hotline or similar mechanism to contractor management (outside the

Companies might consider using a policy guide similar to this.

Standards of Conduct and Business Ethics for Buyers

I. General Policy

It is the policy of (your company name) to consider salespeople and suppliers as important components of the procurement process. Buyers will select vendors that are responsible and competent to serve the company's needs. Procurements shall be made with complete impartiality based on the merits of supplier proposals and applicable related considerations.

II. Applicability

This policy shall apply to all procurement personnel and to other employees who may directly or indirectly influence vendor selection.

III. Procurement Policies and Objectives

The Purchasing Department is responsible for all functions related to the acquisition of supplies and services and for the administration of such purchase orders/subcontracts. In performing these functions, buyers will adhere to the following objectives:

1. Make all purchases in the best interest of the company and the government.
2. Obtain the quality of supplies/services needed for delivery at the time and place required.
3. Buy from responsible sources of supply.
4. Obtain the maximum value for all expenditures.
5. Develop a competitive procurement environment compatible with the company's requirements.
6. Avoid favoritism. Deal fairly and impartially with all vendors.
7. Maintain dependable sources of supply.
8. Document each transaction as required by company and government acquisition regulations.
9. Do not solicit personal favors. Refuse all gifts, entertainment, and anything of monetary value from suppliers.
10. Procure a fair share of supplies/services from small, minority, women-owned, and labor-surplus-area concerns.
11. Be above suspicion of unethical behavior at all times. Avoid any conflict of interest or even the appearance of a conflict of interest in all company-supplier relationships.
12. Report any identical bids and suspected violations of antitrust statutes to the Purchasing Manager for review and possible referral to the government.

purchasing chain) for use by employees and suppliers in reporting possible wrongdoing; and,

- A policy requiring the reporting of unethical conduct to the government and subsequent restitution of any resulting gain.

The government further advised that this program will be subject to review during the contractor's next regularly scheduled CPSR and that a contractor policy evidencing implementation of the safeguards is to be furnished to the government by a specified date.

The letter clearly establishes that the government plans to combat wrongdoing via contractor self-governance and that contractors must institute stringent internal controls to assure compliance with the program. The thrust of the letter closely parallels the Packard Commission recommendation stating that contractor internal controls should be adopted/improved in the following areas: 1) development of a code of business ethics and conduct addressing problems and procedures applicable to defense procurement; 2) enforcement of effective internal contractor controls to ensure compliance with the code; 3) adoption of an internal auditing system to monitor compliance with the code; and, 4) oversight of the code by an independent committee.

IV. Treatment of Salespeople and Suppliers

Treat salespeople and suppliers courteously, fairly, and equally. In this regard, buyers will adhere to the following general practices:

1. Maintain relationships with suppliers in a professional, businesslike, and cordial manner.
2. Make every effort to see each salesperson/supplier who comes to solicit company business. Receive supplier representatives promptly and courteously.
3. Give each supplier an equal opportunity to quote on the company's needs.
4. Do not ask a supplier to make a second quotation unless each vendor solicited is given an opportunity to rebid.
5. You may divulge the successful vendor's name upon request. Prices, specifications, delivery, and other confidential data, however, shall not be revealed to competing suppliers or to others who do not have a need to know.
6. Cooperate with suppliers insofar as possible and do not take advantage of obvious supplier errors or unnecessarily increase supplier expenses.

V. Policy Regarding Gratuities and Kickbacks

Procurement actions under government-funded contracts shall be conducted in a manner above reproach and with complete impartiality. Transactions involving government funds require the highest degree of trust and standards of conduct. In this regard:

1. Buyers shall avoid any action or circumstances — such as a gratuity (a payment or gift to obtain favorable treatment or influence the award of an order), family relationship, or financial interest — that might conflict with the proper performance of their duties or compromise the company's acquisition process.
2. Company employees shall not solicit or accept, directly or indirectly, any gift, favor, entertainment, loan, or anything of monetary value from anyone who is seeking to obtain business from the company.
3. Buyers will, at all times, conduct themselves in a manner that maintains trust and confidence in the integrity of the company's procurement process.

VI. Safeguards

To assure compliance with the above policies, the following procedures shall be in effect:

1. Procurements of $25,000 or more require the approval of the Purchasing Manager or his designee before award.
2. Buyers' purchasing assignments will be periodically rotated insofar as feasible.
3. Management will check with suppliers periodically to determine if there have been any irregularities or questionable conduct by company buyers.
4. An open-door policy, which permits all employees/suppliers access to company management regarding any concern deemed important, may be used by employees and suppliers to bring any complaint of unfair treatment, request for a gratuity or kickback, conflict of interest, or other unethical or dishonest behavior to the company's attention. Or, employees/suppliers may use the company hotline (insert telephone number) to report any suspicion of wrongdoing. Each call will be promptly investigated. The caller may remain anonymous.
5. Unethical conduct of a serious nature, or repetition of minor infractions, will be reported to the government. The parties involved shall make restitution of any gain resulting from such actions.

Kickbacks

The purpose of the Anti-Kickback Act of 1946 (41 U.S.C. 51-54) is to deter subcontractors from making payments to contractors to influence the award of subcontracts. The act:

- Prohibits payments by a subcontractor as an inducement or acknowledgement for the award of a subcontract or order;
- Prohibits the subcontractor from charging such payments to the prime contractor or any higher-tier subcontractor;
- Creates a conclusive presumption that such payments have been included in the price of the subcontract or order;
- Provides that the government may recover such payments from the subcontractor; and,
- Imposes criminal penalties on any person who knowingly makes or receives such payments.

The Anti-Kickback Enforcement Act of 1986 (Pub. L. 99-634) expanded the scope of the prior law and, in addition, requires contractors to: (1) have internal procedures to prevent/detect violations, (2) report suspected violations to the government, and (3) cooperate with any government investigation of possible wrongdoing.

FAR clause 52.203-7, "Anti-Kickback Procedures," requires compliance with the act by primes and subs at all tiers.

Gratuities

The government may terminate a prime's contract, initiate debarment or suspension procedures, and assess exemplary damages if it is determined that a contractor offered or gave a gratuity (entertainment, gift, or payment) to a government employee to obtain favorable treatment or to influence the award of a contract. Three conditions must exist to constitute a violation under the Gratuities clause (FAR 52.203-3): 1) the contract must include the Gratuities clause; 2) the contractor must have offered or given a

(continued on page 43)

gratuity to a government employee; and, 3) the gratuity was intended to obtain favorable treatment or to influence the award of a contract.

Although the Gratuities clause is not a mandatory flow-down provision from the prime to a sub, it should be included in subcontracts/purchase orders so that the prime will have the right to terminate a sub and recover damages if the sub violates this provision.

Contingent Fees

A contingent fee is a commission, percentage, brokerage, or other payment that is made conditioned upon the success of a third person/agency in securing a government contract for a contractor. Contingent fees are prohibited by law because such arrangements can lead to the exercise of improper influence. An exception is permitted, however, in the case where a contingent fee arrangement is customary in the trade and is made between contractors and bona fide employees/agencies that neither exert improper influence nor claim to be able to obtain a government contract by means other than merit.

Prime contractors are required to provide a warranty against contingent fees on each solicitation. Violation of the warranty may lead the government to cancel the contract or recover the amount of the contingent fee.

It is not mandatory for prime contractors to flow down the Contingent Fee clause (FAR 52.203-5) to subcontractors. Again, however, this should be done so that the prime is protected in the event of improper influence on its behalf by a sub.

Noncompetitive Practices

Noncompetitive practices are a violation of the antitrust laws passed by Congress to foster competition. Vendor practices that suggest antitrust violations include:

- Identical bids;
- Use of an industry price list or uniform estimating;
- Concurrent supplier price increases or decreases;
- Rotation of low bids;
- Sharing or division of business between vendors;
- Collusive bidding; and,
- Teaming agreements or joint ventures between major suppliers.

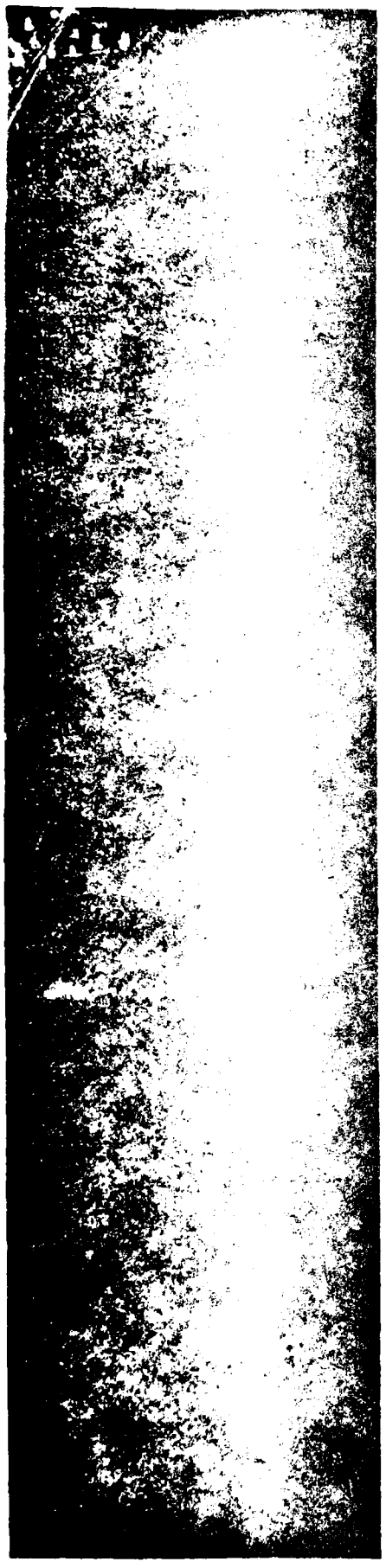
Any evidence of vendor practices that suggest antitrust violations should be reported to the government and may result in criminal, civil, or administrative action against those involved.

A Policy Guide for Contractors

The policy guide on pages 18 and 19 may be useful to defense contractors that want to establish an internal code-of-ethics purchasing policy that complies with the government safeguard recommendations. ■

ABOUT THE AUTHOR

Calvin Brusman is a member of NCMA's Greater Philadelphia (PA) Chapter and has been a subcontract specialist for more than 20 years. He is a Fellow of NCMA.



by Calvin Brusman

Am I On the Government's Review List?

Government contractors and subcontractors having annual negotiated sales of $10,000,000 or more to the government and/or to government prime contractors are subject to comprehensive inspections of their purchasing system each year. The inspections are known as "Contractor Purchasing System Reviews" (CPSRs), pronounced "sipsirs."

A CPSR provides a means for evaluating the effectiveness of the contractor's purchasing system regarding the expenditure of government funds and for determining the contractor's compliance with government procurement regulations. The review provides a basis for the government to grant, withhold, or withdraw approval of the contractor's purchasing system.

Following the CPSR, the government will provide the contractor a detailed report of its findings, including recommendations for correcting any deficiencies.

If a contractor's purchasing system approval is withheld or withdrawn, the government normally performs a followup review to determine if the contractor has implemented the corrective recommendations. Continued failure to correct deficiencies may result in increased government surveillance of the contractor's procurements or other actions by the government to induce contractor compliance.

What Contractor Data Must I Furnish?

Prior to the CPSR, the government will confirm the dates for the review (normally about a two-week period for the initial review) and will request detailed information regarding the contractor's purchasing system. The following is a partial list of information requested.

- copies of the contractor's company organization chart down to at least the department-head level
- copies of the contractor's purchasing organization chart showing the number and job classification of personnel
- copies of purchasing policies/procedures
- copies of all important purchasing forms
- a summary of purchasing actions during the past 12 months including the total dollar value of all purchases and the number of subcontracts/purchase orders by dollar category
- a summary of sales volume for the past 12 months indicating total commercial sales and government sales broken down by department or agency and type of contract
- a list of major, outstanding procurements showing subcontractor's name, item being purchased, type of order, and total dollar value
- copies of weekly or monthly management reports, such as purchasing reports, shortage reports, workload and work backlog reports, scrap/salvage reports, and repetitive reports to company management and the government

The government's request for contractor purchasing/sales information includes a format that contractors may use for ease in furnishing this data.

What Happens at the Entrance Conference?

On the first day of the CPSR, the review team will hold a brief, informal meeting with the contractor to explain the objectives of the review, how the review will be conducted, and to arrange coordination between the team and the contractor's organization.



ABOUT THE AUTHOR

Calvin Brusman has been a subcontracts specialist for more than 20 years. He is a member and past president of the Greater Philadelphia Chapter of NCMA and a NCMA Fellow. He is also active in the Philadelphia Chapter of the National Association of Purchasing Management (NAPM).

During the conference, the review team will stress these four items 1) the objectivity of the team's approach, 2) that the review is based on the contractor's total purchasing system and that patterns of operation, rather than isolated deficiencies, will be the focus of the team's attention, 3) the potential benefits of the review, and 4) that the team is made up of purchasing specialists who are well qualified to make constructive suggestions

Following the review team's presentation, the contractor may advise the team of his company's history, product line, organization, etc

How Will the Government Evaluate My Company's Policies and Procedures?

Contractor's procurement policies and procedures are evaluated on the basis of their scope, thoroughness, and effectiveness This is to ensure that government funds are prudently spent in accordance with public law, the DAR/FAR, executive orders, and other applicable procurement regulations.

The government considers certain procurement policies and procedures so important that their inclusion in the contractor's purchasing manual or operating practices is necessary for the contractor to obtain approval of his purchasing system. These policies and procedures are listed in Figure 1

The contractor should be sure to include these statements in his policies and procedures text

- The engineering department determines what supplies/services are required and may recommend sources, but purchasing decides from whom the supplies/services will be bought and has sole responsibility for the subcontract/purchase order price.
- Pyramiding profits on work performed within the company is not permitted.
- The contractor will take advantage of all available vendor discounts
- The use of cost-plus-a-percentage-of-cost type subcontracts is not permitted
- Purchase orders/subcontracts shall indicate the government prime contract number and priority rating.
- Purchase order requisitions shall include a firm delivery date The vendor's quoted delivery should be indicated in lieu of "ASAP."
- The purchase order requisition is to be date stamped when fully approved
- The contractor shall provide advance notification and obtain ACO prior consent for a procurement, when applicable, even though the prime contract may state a preferred source.

How Will the Government Conduct the Review of My Company's Subcontracts/ Purchase Orders?

The review team will select a random sampling of subcontracts/purchase orders placed within the past 12 months for detailed analysis Normally the team reviews about 50 subcontracts/purchase orders in each of the following dollar categories a) under $10,000 (small dollar), b) $10,000 to $25,000 (low dollar), c) $25,000 to $100,000 (intermediate dollar), and d) $100,000 and above (high dollar).

The orders in category *a* are analyzed and the results recorded on a spread sheet (See DAR Supplement No. 1, Attachment 2, for a reproduction of the spread sheet format.)

The orders in categories *b*, *c*, and *d* are analyzed and the results recorded on spread sheet DLA Form 604 (See DAR Supplement No. 1, Attachment 1, for a reproduction of this spread sheet format.) A separate DLA Form 604 is used for each dollar category so that any patterns of deficiencies within a dollar category are easily discernible

What Are Minor Procurement Deficiencies? What Are Major Procurement Deficiencies?

A minor deficiency is one that does not significantly affect the expenditure of government funds or relate to compliance with prime contract clause requirements.

A major deficiency is a failure on the contractor's part to reduce contract costs, analyze vendor cost or pricing data, encourage competition, improve purchasing effectiveness, or comply with public law and prime contract clauses

More specifically, the contractor is a loser if he

a) fails to provide advance notification and written justification for a procurement to the government and does not obtain prior government consent for an award, when required in accordance with the subcontracts clause of the prime contract (Advance Notification and Consent, 10 U.S Code 2306(e))

b) fails to obtain cost or pricing data and certification, when required, for procurements expected to exceed ~~$500,000~~ $100,000. (Public Law 87-653 as amended, "Truth in Negotiations Act")

c) fails to obtain the vendor's disclosure statement, certificate of concurrence of prior filing, certificate that a disclosure statement is not required, or certificate of exemption, or fails to include the required flowdown clauses in Cost Accounting Standards covered subcontracts in excess of $100,000, when such requirements apply (Public Law 91-379, "Cost Accounting Standards Act")

d) includes improper restrictive clauses in subcontracts/purchase orders which limit the government's contractual rights or restrain subcontractors from selling supplies or spare parts directly to the government when the government has a vested interest or right to procure such supplies/spare parts directly from a subcontractor. (DAR S1-304 2(b))

e) fails to correct previously noted minor deficiencies or, when many minor deficiencies, taken collectively, equal a major deficiency.

Isolated instances of major deficiencies are not normally considered a basis for withholding a contractor's purchasing system approval Prior to noting any deficiencies in the contractor's formal CPSR Report, the review team will discuss problem areas with the contractor or use other means to substantiate its findings

What Happens at the Exit Conference?

On the last day of the in-plant review, an exit conference is held to present the review team's general observations to the contractor However, no recommendations pertaining to the contractor's purchasing system status is made at this time.

The review team will give the contractor a letter stating the team's recommendations and request that the contractor respond within 15 days with a plan for corrective action. The contractor will be informed that after a response is received and the CPSR report completed, the contracting officer will notify the contractor of his purchasing system status. □

Figure 1

Procurement Policies and Procedures to be Included in Contractor's Purchasing Manual or Operating Practices

1. ACO Advance Notification, Written Justification, and Prior Consent
2. Buyer Symbols and Dollar Commitment Authority
3. Certification of Vendor Nonsegregated Facilities
4. Clean Air and Water Act and Certification
5. Communications and Relations With Vendors
6. Conflicts of Interest and Improper Business Practices
7. Control of Cost Reimbursement Type Subcontracts
8. Cost Accounting Standard 414, "Cost of Money"
9. Documentation Checklists for Procurement Actions
10. Dollar Approval Authority of Contractor Personnel
11. Equal Opportunity Compliance by Vendors
12. Expediting and Followup of Procurements
13. Intra-Company Transactions
14. Inventory Control
15. Letter Subcontracts
16. Make-or-Buy Evaluation Program
17. Negotiations and Negotiation Memorandums
18. Patent Rights Provisions Applicable to Subcontracts
19. Preaward Surveys
20. Price and Cost Analysis, Including Degree of Competition
21. Prime Contract Flowdown Clauses and Provisions
22. Processing Changes to Purchase Orders/Subcontracts
23. Processing Purchase Order Requisitions, Including Authorized Contractor Signatures
24. Processing Requests for Quotations/Proposals
25. Procurement of Spare Parts
26. Procurements Requiring Government Source Inspection
27. Procurements Requiring Government Property Administration
28. Progress Payments to Vendors
29. Prompt Payment Discounts Policy
30. Public Law 87-653, Including Guidance Concerning Standard Forms SF 1411 and SF 1412
31. Public Law 91-379, Cost Accounting Standards Requirements Applicable to Vendors
32. Purchasing's Role as Sole Authority to Make Commitments to Vendors
33. Receipt/Inspection of Incoming Vendor Supplies
34. Reciprocity
35. Retention of Procurement Records
36. Return of Damaged/Unsatisfactory Materials
37. Safeguarding Classified Information
38. Savings Reports
39. Selection of Subcontract Type
40. Single/Sole Source Procurements and Justification
41. Small Business/Small Disadvantaged Business Subcontracting Plan
42. Small Business, Minority Business and Labor Surplus Areas Subcontracting Program
43. Small Purchases/Blanket Purchasing Agreements
44. Subcontract Administration of Major Procurements
45. Subcontract/Purchase Order Close-Out
46. Subcontractor Special Tooling/Special Test Equipment Costs
47. Source Selection and Responsibility for Subcontract/Purchase Order Price
48. Terminations
49. Unpriced Orders Policy
50. Value Analysis
51. Value Engineering
52. Vendor Cost and Progress Reporting Requirements
53. Vendor Performance Rating
54. Vendor Quality Control/Quality Assurance Requirements

NOTES

CHAPTER I

This chapter involves an explanation of the various types of modifications that may be encountered in government contract administration.

Topics such as scope of work, constructive changes, various changes clauses, equitable adjustment, and other possible alternations of a contract will be reviewed.

Two new approaches to the study of these will be offered in this edition. First, a series of questions highlighting important areas of study precedes the text materials as a useful study guide, and second, FAR Part 43, Contract Modifications, is included to acquaint the reader with the policy provisions governing this subject matter.

All references to specific clauses or other provisions are from the Federal Acquisition Regulation (FAR). It should be noted, however, that the Defense Acquisition Regulation (DAR) and the Federal Procurement Regulation (FPR) continue to be operative in many contract circumstances.

FAR language, it is said, simplified the form without changing the substances. Comparison of the new FAR provisions s with the old DAR/FPR provisions is readily available through widely-used cross-reference indices.

An important caveat, however: At all the contract administrator should keep in mind the concept of fairness, reasonableness and equity in the administration of changes. Neither party to the contract should be punished as a result of a valid changes, nor should either be unduly benefited or rewarded for pursuing its obligations in the changed circumstance.

The assignments follows:

	Topic	PAGE	ASSIGN
1.	Key Issues in Changes and Equitable Adjustments (Eight Questions)	I-1.2	Review
2.	Modification of Contracts	I-2 thru I-38	Read
3.	Equitable Adjustments	I-39 thru I-61	Read
4.	FAR Part 43, Contract Modification	I-62 thru I-64	Review

SCHOOL OF SYSTEMS AND LOGISTICS

ADVANCED CONTRACT ADMINISTRATION COURSE (PPM 304)

SUBJECT: Contract Modifications

TIME: 7.0 Hrs

OBJECTIVE: Comprehend the purpose and function of contract modifications in CAS.

SAMPLES OF BEHAVIOR:

a. Apply the concept of "within the general scope of the contract."

b. Define the concept of constructive change.

c. Describe the elements of the changes clause.

d. Explain the concept of equitable adjustment.

INSTRUCTIONAL METHODS: Lecture/Discussion
Workshop
Case Analysis

STUDENT INSTRUCTIONAL MATERIALS: ACA Textbook

REQUIRED STUDENT PREPARATION: As defined in Chapter "I" of ACA textbook.

ADVANCED CONTRACT ADMINISTRATION

1. Which of the following would be a proper (or improper) modification of a contract and why?

a. a change order increasing or reducing the number of items to be supplied under the contract;
b. A "cardinal" change;
c. a change order substituting basic materials and processes.

2. Why is the phrase "within the scope of the contract" so important? What does it mean?

3. What are the significant differences between the modern Changes philosophy (as embodied in the FP Construction Contract Changes Clause--FAR 52.243-4) and the old Changes attitude (as reflected in the FP Supply Contract Changes Clause--FAR 52.243.1)?:

4. What is a "constructive" change? How does it happen? What is its basis? How can you prevent/control it? Where do you find the "constructive change" embodied in a standard clause?

5. It is said that government contract Changes concepts are one-sided; i.e.., they invariably operate in favor of the government, and this should be so in the interests of public policy. Dissect and discuss in detail.

6. In reference to equitable adjustment, what is an impact cost and a ripple effect? What is the difference between "direct" and "consequential" damages? Which are recoverable and why?

7. The proper measure of an equitable adjustment is defined in the "Bruce Case Rule." In four words, define the rule. What are the implications of this rule as far as the contracting parties are concerned? Discuss.

8. The concept of "Contracting Officer" is basic to the understanding of authority in government contracting. Who is a "Contracting Officer'? What impact does your definition have upon understanding "constructive" changes? Discuss in depth.

MODIFICATIONS

by

Eileen Donnelly
Professor of Contract Law & Management

This chapter discusses the modification of Government contracts. Even though much time and effort is involved in the formation of these contracts, a significant number require modification. Black's Law Dictionary, Fourth Edition, West Publishing Company (1951) defines modification as:

> A change; an alteration which introduces new elements into the details, or cancels some of them, but leaves the subject-matter intact.

The ability to modify Government contracts provides the flexibility that is necessary to assure that individual procurements will provide that which the Government needs.

The chapter begins with a discussion of how modifications are used, the authority to modify a Government contract and the types of modifications. The Changes clauses are included in their entirety with an analysis of each clause. The chapter ends with a discussion of a variety of modifications that are not under the Changes clauses.

1-1. Circumstances Indicating Modification. Many Government contracts are performed over a long period of time during which the state-of-the-art may change. New developments, improved knowledge and technical breakthroughs may have occurred that were beyond expectation at the time of the contract award. Modifications may effectively bring this new technology into the existing contract.

1-2. A modification can provide information that was not available at the time the contract was written. For example, spare parts lists or amended shipping instructions.

1-3. On occasion, contracts are drafted with the understanding that additional contract language will be added at a later date. This occurs when it is urgent to get requirements on a contract to protect an early delivery schedule.

1-4. Modifications are frequently necessary when circumstances arise that impair the performance of a contract. This may be the fault of the Government, or the contractor, or be beyond the control of either party. A modification can safeguard the interests of the Government and at the same time protect the welfare of the contractor.

1-5. It is apparent from the examples above that there is a wide variety of circumstances that indicate the need to modify a

contract. It may assist a contractor, but in the last analysis a modification must be in the best interests of the Government.

2-1. **Authority**. Contracting Officers who have the authority to enter into a contract have the authority to modify a contract. The Changes Clause also grants authority to the Contracting Officer. The Administrative Contracting Officer (ACO) has the authority to make administrative changes by delegation from the Procurement Contracting Officer (PCO). These modifications include changing the paying office, if it is incorrect on the contract, appropriation data or other information that is not substantive. All other modifications are by action of the PCO.

2-2. Another side of the question of authority arises when Government personnel interact with contractor personnel. The Supreme Court stated quite clearly in Federal Crop Insurance Corp. v. Merrill, 332 U.S. 380 (1947):

> Whatever the form in which the Government functions, anyone entering into an arrangement with the Government takes the risk of having accurately ascertained that he who purports to act for the Government stays within the bounds of his authority....And this is so even though ... the agent himself may have been unaware of the limitations upon his authority.

2-3. The contractor who follows instructions from all Government personnel who appear during the contract performance will probably find that some of the Government employees had no authority to initiate changes. The experienced contractor will request a letter from the awarding agency, if it is not forthcoming, that identifies the personnel with whom the contractor will be dealing. This list should include the limits on the actual authority of each person.

2-4. Some agencies have drafted contract clauses that set out the authority of the Government's personnel working on the contract.

For instance, the GSA in its construction contracts uses an "Authorities And Limitations" clause (GSA Supp. 552.236-71), which provides that:

(a) All work shall be performed under the general direction of the Contracting Officer, who alone shall have the power to bind the Government and to exercise the rights, responsibilities, authorities and functions vested in him by the contract documents, except that he shall have the right to designate authorized representatives to act for him. Wherever any provision in this contract specifies an individual (such as, but not limited to Construction Engineer, Resident Engineer, Inspector or Custodian) or organization; whether Governmental or private, to perform any act on behalf of or in the interests of the Government, that individual or organization shall be deemed to be the Contracting Officer's authorized representative under

this contract but only to the extent so specified. The Contracting Officer may, at any time during the performance of this contract, vest in any such authorized representatives additional power and authority to act for him or designate additional representatives, specifying the extent of their authority to act for him; a copy of each document vesting additional authority in an authorized representative shall be furnished to the Contractor.

(b) The Contractor shall perform the contract in accordance with any order (including but not limited to instruction, direction, interpretation or determination) issued by an authorized representative in accordance with his authority to act for the Contracting Officer; but the Contractor assumes all the risk and consequences of performing the contract in accordance with his authority to act for the Contracting Officer; but the Contractor assumes all the risk and consequences of performing the contract in accordance with any order (including but not limited to instruction, direction, interpretation or determination) of anyone not authorized to issue such order.

2-5. In addition to setting forth, very plainly , who has authority and under what circumstances, the last portion of section (a) requires that a copy of any document vesting authority in a representative be provided to the contractor. It is one more effort to keep open the lines of communication.

2-6. The potential for legal and technical problems that may result from unauthorized Government personnel actions was addressed by DOD in DFARS 43104(a):

> Government representatives shall avoid conduct (written or oral communications, actions and inactions) that could constitute an unauthorized unilateral change in the terms and conditions of a contract. When a contracting officer or other Government representative, by conduct, causes a contractor to perform changed work, such conduct may be the basis for a claim buy the contractor. Government representatives shall act promptly to resolve such situations as soon as they are made known to the Government.

2-7. Part 43 of the FAR states the Government policy on authority to modify contracts and the pricing of modifications.

42.1-2 Policy.

(a) Only contracting officers acting within the scope of their authority are empowered to execute contract modifications on behalf of the Government. Other Government personnel shall not--

(1) Execute contract modifications;

(2) Act in such a manner as to cause the contractor to believe that they have authority to bind the Government; or

(3) Direct or encourage the contractor to perform work that should be the subject of a contract modification.

(b) Contract modifications, including changes that could be issued unilaterally, shall be priced before their execution of this can be done without adversely affecting the interest of the Government. If a significant cost increase could result from a contract modification and time does not permit negotiation of a price, at least a maximum price shall be negotiated unless impractical.

3-1. **Nature of Contract Modifications.** A modification may be bilateral or unilateral.

Bilateral modifications are called Supplemental Agreements. The Government and the contractor mutually agree on a change to the contract that is within the scope of the contract. This Supplemental Agreement has the offer, acceptance and consideration elements of a new contract. The advantage over a unilateral modification is that an adjustment of money and/or time for performance will have been reached before the change is made. The change may add work or delete work or substitute work.

3-2. The FAR describes contract modifications as follows:

43.103 Types of contract modifications.

Contract modifications are of the following types:

(a) Bilateral. A bilateral modification (supplemental agreement) is a contract modification that is signed by the contractor and the contracting officer. Bilateral modifications are used to--

(1) Make negotiated equitable adjustments resulting from the issuance of a change order;
(2) Definitize letter contracts; and
(3) Reflect other agreements of the parties modifying the terms of contracts.

(b) Unilateral. A unilateral modification is a contract modification that is signed only by the contracting officer. Unilateral modifications are used, for example, to--

(1) Make administrative changes;
(2) Issue change orders;
(3) Make changes authorized by clauses other than a changes clause (e.g., Property clause, Options clause, Suspension of Work clause, etc.); and
(4) Issue termination notices.

3-3. Unilateral Modifications are changes in the contract that come about through the action of the Contracting Officer. The contractor is not consulted nor does he have to agree with the

change. At common law one party to a contract cannot unilaterally change the obligations of both parties. But a Government contract, by agreement of the parties, contains a Changes clause pursuant to which the contracting officer may order modifications not only in the administrative details of Government contract administration (such as the cognizant financing office or the name of the contracting officer) but also in the important substantive matters of design and manufacturing methods, construction details, and place of delivery and packaging. The clause permits the Government to range widely in varying the technical aspects of the work statement, often with drastic effect on the contractor's production schedules, materials purchases, engineering effort and utilization of personnel. Severe financial impact usually accompanies severe changes. Of course, an equitable adjustment of the contract price is provided for in the clause.

2-4. Justification for such an usual power is found in the need of the Government for flexibility in meeting the changing military needs of our country. In this way, new technology may be incorporated into the contractor's effort during contract performance. Amended shipping instructions and packaging requirements add further flexibility, and permit quick response to changed or unanticipated circumstances. Without this right, procurement response to military requirements would be severely hampered.

3-4. A Unilateral modification may be a change under the Changes Clause, a constructive change, or a modification under one of a variety of other clauses that provide for changes. We will explore these areas individually.

4-1. **The Scope of the Contract.** Changes must be within the scope of the contract. There is no clear line demarking changes within the scope and changes outside the scope of the contract. Each case must be viewed on the fact situation and a determination made as to whether the nature and function of the change will fundamentally alter the nature of the contract.

4-2. The United States Court of Claims stated in Air-A-Plane Corp. v. United States, 408 F.2d 1030 (Ct. Cl. 1969). The basic standard... is whether the modified job" was essentially the same work as the parties bargained for when the contract was awarded." The change will be regarded as within the general scope when it could be fairly and reasonably be considered to be within the contemplation of the parties at the time the contract was entered into. Freud v. United States, 260 U.S. 60 (1922).

4-3. A change that is outside the scope is a cardinal change and is a new procurement requiring new funding. This kind of a change occurs when the changed work is not the same as that which the parties bargained for when entering into the contract. The contractor may elect to perform a cardinal change and then seek an equitable adjustment under the Changes clause. But, if the

contractor is certain the change is outside the scope of the contract, he may refuse to perform the change.

4-4. Multiple Changes. A contracting officer who issues many changes is not necessarily changing beyond the scope of the contract. Aragona construction Co. v. United States, 165 Ct. Cl.382 (1964) held that multiple changes that altered materials to be used in the construction of a hospital were within the scope of the contract because the hospital was not different in size or performance after the changes were made.

5-1. **Changes Clause.** The entire concept of changes rests upon the advance agreement between the Government and the successful contractor in the original contract, manifested by a Changes clause. It is only through contract agreement that the unilateral action by the contracting officer is authorized. The particular Changes clause inserted in a contract varies with the type of contract entered into by the Government and a contractor. The Changes clause in a fixed-price supply contract will differ slightly from the Changes clause in a cost-reimbursement supply contract. However, there is a common thread running through all changes clauses. The common elements of a Changes clause include the requirements that (1) a change must be within the scope of the contract, (2) the order to change must be in writing, and (3) the ordered changed must be at the order of an authorized Government officer.

5-2. All of the changes clause require the contractor to submit a timely claim for an equitable adjustment, some of the clauses require the contractor to provide the Contracting Officer with timely notice that it considers certain actions of the Government to constitute constructive changes. The courts and boards have created exceptions to the notice requirement and do not strictly enforce it.

5-3. Types of Contracts and Changes Clauses. An analysis of the several Changes clauses now in use discloses a wide variety of legal ramifications. The language in the clauses has evolved through years of use and has been extensively interpreted by administrative and judicial tribunals. An analysis of the clauses relative to changes in various types of Government contracts will illustrate the current application of the clauses.

5-4. Fixed-Price Supply Contract Clause (Required)

52.243-1 Changes-Fixed-Price.

As prescribed in 43.205(a0(1), insert the following clause in solicitations and contracts when a fixed-price contract for supplies is contemplated. The 30-day period may be varied according to agency procedures.

CHANGES-FIXED-PRICE(APR 1984)

(a) The Contracting Officer may at any time, by written order, and without notice to the sureties, if any, make changes within the general scope of this contract in any one or more of the following:

(1) Drawings, designs, or specifications when the supplies to be furnished are to be specially manufactured for the Government is accordance with the drawings, designs, or specifications.

(2) Method of shipment or packing.

(3) Place of delivery.

(b) If any such change causes an increase or decrease in the cost of, or the time required for, performance of any part of the work under this contract, whether or not changed by the order, the Contracting Officer shall make an equitable adjustment in the contract price, the delivery schedule, or both, and shall modify the contract.

(c) The Contractor must submit any "proposal for adjustment" (hereafter referred to as proposal) under this clause within 30 days from the date of receipt of the written order. However, if the Contracting Officer decides that the facts justify it, the Contracting Officer may receive and act upon a proposal submitted before final payment of the contract.

(d) If the Contractor's proposal includes the cost of property made obsolete or excess by the change, the Contracting Officer shall have the right to prescribe the manner of the disposition of the property.

(e) Failure to agree to any adjustment shall be a dispute under the Disputes clause. However, nothing in this clause shall excuse the Contractor from proceeding with the contract as changed.

(End of clause)
(R 7-103.2 1958 JAN)
(R 1-7.102-1)

This basic fixed-price changes clause has five alternate provisions, covering services when no supplies are to be furnished, services when supplies are to be furnished, architect engineer services, other professional services, transportation services, and research and development contracts.

5-5. FAR 52.243-1

Alternate I (APR 1984). If the requirement is for services, other than architect-engineer or other professional services, and no supplies are to be furnished, substitute the following paragraph (a) for paragraph (a) of the basic clause.

(a) The Contracting Officer may at any time by written order, and without notice to the sureties, if any, make changes within the general scope of this contract in any one or more of the following:

(1) Description of services to be performed.

(2) Time of performance (i.e., hours ot the day, days of the week, etc.).

(3) Place of performance of the services.

(R 7-1902.2 1971 NOV)

Alternate II (APR 1984). If the requirement is for services (other than architect-engineer services, transportation, or research and development) and supplies are to be furnished, substitute the following paragraph (a) for paragraph (a) of the basic clause:

(a) The Contracting Officer may at any time, by written order, and without notice to the sureties, if any, make changes within the general scope of this contract is any one or more of the following:

(1) Description of services to be performed.

(2) Time of performance (i.e., hours of the day, days of the week, etc.).

(3) Place of performance of the services.

(4) Drawings, designs, or specifications when the supplies to be furnished are to be specially manufactured for the Government in accordance with the drawings, designs, or specifications.

(5) Method of shipment or packing of supplies.

(6) Place of delivery.

(R 7-1902.2 1971 NOV)
(R 7103.2 1958 JAN)
(R 1-7.102-2)

Alternate III (APR 1984). If the requirement is architect-engineer or other professional services, substitute the following paragraph (a) for paragraph (a) of the basic clause and add the following paragraph (f):

(a) The Contracting Officer may at any time, by written order, and without notice to the sureties, if any, make changes within the general scope of this contract in the services to be performed.

(f) No services for which an additional cost or fee will be charged by the Contractor shall be furnished without the prior written authorization of the Contracting Officer.

(R 7-607.3 1972 APR)

Alternate IV (APR 1984). If the requirement is for transportation services, substitute the following paragraph (a) for paragraph (a) of the basic clause:

(a) The Contracting Officer may at any time, by written order, and without notice to the sureties, if any, make changes within the general scope of this contract in any one or more of the following:

(1) Specifications.

(2) Work or services.

(3) Place of origin.

(4) Place of delivery.

(5) Tonnage to be shipped.

(6) Amount of Government-furnished property.

(R 1-7.703-2)

Alternate V (APR 1984). If the requirement is for research and development and it is desired to include the clause, substitute the following subparagraphs (a) (1) and (a)(3) and paragraph (b) for subparagraphs (a)(1) and (a)(3) and paragraph (b) of the basic clause:

(1) Drawings, designs, or specifications.

(3) Place of inspection, delivery, or acceptance.

(b) If any such change causes an increase or decrease in the cost of, or item required for, performing this contract, whether or not changed by the order, the Contracting Officer shall make an equitable adjustment in (1) the contract price, the time of performance, or both; and (2) other affected terms of the contract, and shall modify the contract accordingly.

(R 7-304.1 1965 JUN)

5-6. Analysis of Provisions of the Clause. This section briefly covers the areas that are likely to be discussed by contracting parties when changes are introduced into a contract. There are seven major points discussed below

5-7. "The Contracting Officer". Changes under the clause are effected by the Contracting Officer who is defined in the definitions portion of the contract. The definition as set out in the supply contract is:

> "Contracting Officer" means a person with the authority to enter into, administer. and/or terminate contracts and make related determinations and findings. The term includes certain authorized representatives of the Contracting Officer acting within the limits of their authority as delegated by the Contracting Officer. (FAR 52.202-1(b)).

5-8. It is important for the contractor to realize that not every Government official who appears at his plant or on a construction project is an authorized representative of the Contracting Officer for the purpose of directing changes. The contractor should beware of an overzealous engineer or inspector. When the contractor discovers that a Government representative with whom he made an agreement, or upon the basis of whose order he affected a change, was not authorized to do so, the contractor can contact the Contracting Officer who would have been authorized to make the change or agreement and who still has such authority and have him commence action to ratify the unauthorized act. The ratification relates back to the date of the transaction ratified. It should be noted that there is no requirement that the Contracting Officer ratify any order or agreement effected by an unauthorized Government representative. It should also be noted that ratification authority may be controlled by local regulation, and, in fact, be restricted to

levels of authority above the Contracting Officer. See discussion of authority at 2-1, supra.

5-9. "By Written Order". In a leading case, Plumley v. United States, 226 US 545 (1913), the Court held that there was a failure to reduce an oral change order to writing and that although substantial extra work was performed the contractor could not recover, as the extra work was not agreed upon in the manner set out in the contract. The requirement that change must be by the written order of the Contracting Officer has been strictly enforced in numerous other Court of Claims and administrative tribunal decisions.

5-10. However, the Court of Claims in the case of Armstrong & Co. v. United States, 98 Ct. Cl. 519 (1943) decided that performance of work without a written change order gave rise to an "implied contract to pay" when the Government received the benefit of the work and the change was performed at the oral direction of a responsible officer. The Court of Claims has held also that a change ordered by an unauthorized representative and later overruled by the responsible officer after the work was completed should be paid for by the Government under the theory of an "implied in fact" contract.

5-11. The administrative appeal boards have, under the circumstances of the case being considered, decided that the Contracting Officer has in fact issued an oral change order, and his refusal to put it in writing was an administrative error which the board was empowered to correct. They have also advanced the theory that they will regard as done that which should have been done, thereby giving the effect of a written order. This is sometimes referred to as the "constructive changes" doctrine. This doctrine has not been extended to the contractor who voluntarily performs work beyond that required by the contract without any direction by a representative of the Government.

5-12. "Without Notice to the Sureties". The revision "without notice to the sureties" is in accordance with the performance bond under which the surety waives notice of modifications of the contract. The words are inserted to preserve full obligations of the surety under the performance bond even though notice of the change is not provided to the surety.

5-13. "Make Changes if Within the General Scope of this **Contract".** The general scope of the contract has been defined by the Supreme Court as what should be regarded as fairly and reasonably within the contemplation of the parties when the contract was entered into. See discussion of scope of the contract at 4-1, supra.

5-14. In deciding whether a change is within the scope of a contract, neither the expense of the changed work nor the number of changes is determinative. However, the addition or deletion of units, i.e., the increase or decrease of a complete building

in a construction contract, has been held to be beyond the scope of the Changes clause. The elimination of a building has been described as a "cardinal change," and should be treated as a partial termination of the contract rather than eliminated by change order. The same rule applies generally when the scope of the contract is increased by the addition of one or more units.

5-15. The fixed-price supply contract Changes clause limits changes (1) to drawings, designs, or specifications where the supplies to be furnished are to be specially manufactured for the Government in accordance therewith; (2) to the method of shipping and packing and (3) to the place of delivery.

5-16. These limitations affect changes which might be made to special items. It is not anticipated the changes to off-the-shelf items will include a change in drawings, designs, or specifications.

5-17. "If any such change causes an increase or decrease in the cost of, or the time required for, the performance of any part of the work under this contract, whether or not changed by the order, the Contracting Officer shall make an equitable adjustment." This clause defines the scope of costs which are to be considered in the computation of the equitable adjustment for a change to a supply contract. Note that the clause embodied in the supply contract includes the words, "whether or not changed by the <change> order."

5-18. **United States v. Rice, 317 US 61.** (1942), has been considered the authority for limiting consideration of costs to the part of t e contract which has been changed. This would relieve the Government from responsibility for additional costs relative to the unchanged portion of the contract. The words "whether or not changed by the <change> order," negate this rule.

5-19. The determination of an equitable adjustment has not been reduced to a science. A full discussion of equitable adjustment is at 8, infra.

5-20. "The Contractor must submit any 'proposal for adjustment' under this clause within 30 days from the date of receipt of the written order." When claims are filed by the contractor after the 30-day period, they will generally be considered by the courts and administrative boards when Government rights are not prejudiced. In certain situations where the Contracting Officer has considered the contractor's request for additional costs after the deadline date and then rejected the claim, his consideration of the claim has given new life to it. The Contracting Officer has exercised the permissive action granted to him in the Changes clause. After giving due consideration to and then refusing the claim, he cannot argue in an appeal to the administrative appeals board that the contractor's claim was filed on an untimely basis. His actions have in effect reinstated the claim.

5-21. The situation differs when a change order has been accepted and the adjustment, if any, agreed to by both parties. If neither party is able to show that agreement was obtained by fraud, duress, collusion or mutual mistake, the agreement is binding as to both the contractor and the Government.

5-22. Even the Contracting Officer has the limitation under the clause that precludes consideration of claims after final payment. Final payment refers to payment under the entire contract. There is some support for the theory that final payment has not been made until claims can no longer be asserted under the contract. If the claim had not been stopped by a release or an accord and satisfaction, then the statute of limitations would finally eliminate the possibility of a claim. Final payment may occur several years after a contract has been performed.

5-23. "Failure to agree to any adjustment shall be a dispute under the Disputes Clause." The contractor's refusal to proceed under a change order would be a breach of contract if the change is within the general scope of the contract. A contractor could validly refuse to proceed if the change ordered was not within the scope of the contract. It would seem to be a risky procedure on the part of the contractor to refuse to proceed even though damages might be enhanced if he could prove a breach of contract.

5-24. Cost Reimbursement Supply Contract Clause (Mandatory)

FAR 52.243-2 Changes-Cost-Reimbursement.

As prescribed in 43.205(b)(1), insert the following clause in solicitations and contracts when a cost-reimbursement contract for supplies is contemplated. The 30-day period may be varied according to agency procedures.

CHANGES-COST-REIMBURSEMENT (APR 1984)

(a) The Contracting Officer may at any time, by written order, and without notice to the sureties, if any, make changes within the general scope of this contract in any one or more of the following:

(1) Drawings, designs, or specification when the supplies to be furnished are to be specially manufactured for the Government in accordance with the drawings, designs, or specifications.

(2) Method of shipment or packing.
(3) Place of delivery.

(b) If any such change causes an increase or decrease in the estimated cost of, or the time required for, performance of any part of the work under this contract, whether or not

changed by the order, or otherwise affects any other terms and conditions of this contract, the Contracting Officer shall make an equitable adjustment in the (1) estimated cost, delivery or completion schedule, or both; (2) amount of any fixed fee; and (3) other affected terms and shall modify the contract accordingly.

(c) The Contractor must submit any "proposal for adjustment" (hereafter referred to as proposal) under this clause within 30 days from the date of receipt of the written order. However, if the Contracting officer decides that the facts justify it, the Contracting Officer may receive and act upon a proposal submitted before final payment of the contract.

(d) Failure to agree to any adjustment shall be a dispute under the Disputes clause. However, nothing in this clause shall excuse the Contractor from proceeding with the contract as changed.

(e) Notwithstanding the terms and conditions of paragraphs (a) and (b) above, the estimated cost of this contract and, if this contract is incrementally funded, the funds allotted for the performance of this contract, shall not be increased or considered to be increased except by specific written modification of the contract indicating the new contract estimated cost and, if this contract is incrementally funded, the new amount allotted to the contract. Until this modification is made, the Contractor shall not be obligated to continue performance or incur costs beyond the point established in the Limitation of Cost or Limitation of Funds clause of this contract.

(End of clause)
(R 7-203.2 1967 APR)
(R 1-7.202-2)

5-25. This clause also has five alternates. Alternates I and II are identical to Alternates I and II for the Fixed Price Supply Contract Clause supra. Alternates II, IV and V follow.

Alternate III (APR 1984). If the requirement is for construction, substitute the following paragraph (a) for paragraph (a) of the basic clause:

(a) The Contracting Officer may at any time, by written order, and without notice to the sureties, if any, make changes within the general scope of this contract in the plans and specifications or instructions incorporated in the contract.

(R 7-605.2 APR)

Alternate IV (APR 1984). If a facilities contract is contemplated, substitute the following paragraphs (a) and (e) for paragraphs (a) and (e) of the basic clause:

(a) The Contracting Officer may at any time, by written order, and without notice to the sureties, if any, make changes within the general scope of this contract in the facilities or work described in the schedule.

(e) Any related contract with the Contractor may be equitably adjusted if it provides for adjustment and is affected by a change ordered under this clause.
(R 7-702.4 1964 SEP)

Alternate V (APR 1984). If the requirement is for research and development, and it is desired to include the clause, substitute the following subparagraphs (a)(1) and (a)(3) for subparagraphs (a)(1) and (a)(3) of the basic clause.

(1) Drawings, designs, or specifications
(3) Place of inspection, delivery, or acceptance.
(R 7-404.1 19678 APR)
(R 1-7.404-5)

5-26. Analysis of Provisions in the Cost-Reimbursement Supply Contract Clause. You will note that the areas subject to change and the method of effecting changes are the same here as for fixed-price supply contracts. However, since the cost-reimbursement contracts are priced and funded on the basis of estimated costs, with or without a fee, the clause reflects this in the provisions for equitable adjustment. The clause provides that if the change causes an increase or decrease in the "estimated" cost or "otherwise affects any other provision of this contract," an equitable adjustment shall be made. The fixed-price contract clause provides for adjustment only to contract price or delivery schedule, or both. This clause provides for adjustment to the estimated cost, delivery schedule, amount of fee and such other provisions of the contract as may be affected.

5-27. The provision in the fixed-price contract clause for the Contracting Officer to prescribe the manner of disposition of property made obsolete or excess as a result of a change is not considered necessary in a cost-reimbursement contract. The costs of such property would have already been charged to the contract.

5-28. The addition of paragraph (e) to the clause is necessary because all cost-reimbursement type supply contracts that are fully funded are required to use a Limitation of Cost clause and all that are incrementally funded are required to use a Limitation of Funds clause. These clauses place restrictions on the Government's obligation to reimburse the contractor and on the contractor's obligation to perform beyond the limitation set forth in the contract schedule. To avoid possible work stoppages, adjustments in estimated cost or fund allocations should be made without undue delay after a change is ordered.

5-29. Research and Development Contracts. The previous R & D clauses have been incorporated as alternate provisions to the basic clauses. See, for example, Alternate V to the fixed-price supply contract changes clause (FAR 52.243-1) and Alternate V to the cost-reimbursement supply contract (FAR 52.243-2). Both clauses have been rewritten without major change in substance.

5-30. Analysis of the Clauses. The Changes clauses for Research and Development contracts are indentified as "additional" clauses and not necessarily required. They may be inserted in accordance with Departmental procedures where the nature of the work justifies and lends itself to such change control. In many cases the "Description of Work" is not sufficiently definitive to provide a base upon which a change might be effected.

5-31. The requirement in supply contracts that drawing, design or specification changes be applicable only to supplies "specially manufactured for the Government" is not applicable to R&D contracts where the work involved is on a Government program. Also, there is seldom any substantial production of supplies on a Research and Development Changes clauses need not include the "specially manufactured for the Government" provision. One other feature of the Research and Development Changes clauses is that changes are permitted in the place of inspection and acceptance as well as the place of delivery.

5-32. Time and Materials Contracts Labor - Hours Contracts

FAR 52.243-3 Changes-Time-and-Materials or Labor-Hours.

As prescribed in 43.205(c), insert the following clause in solicitations and contracts when a time-and-materials or labor-hour contract is contemplated. The 30-day period may be varied according to agency procedures.

Changes-Time-and-materials or Labor-Hours (APR 1984)

(a) The Contracting Officer may at any time, by written order, and without notice to the sureties, if any, make changes within the general scope of this contract in any one or more of the following:

(1) Drawings, designs, or specifications.
(2) Method of shipment or packing.
(3) Place of delivery.
(4) Amount of Government-furnished property.

(b) If any change causes an increase or decrease in any hourly rate, the ceiling price, or the time required for performance of any part of the work under this contract, whether or not changed by the order, or otherwise affects any other terms and conditions of this contract, the Contracting Officer shall make an equitable adjustment in the (1) ceiling price, (2) hourly rates, (3) delivery schedule, and (4) other affected terms, and shall modify the contract accordingly.

(c) The Contractor must submit any "proposal for adjustment" (hereafter referred to as proposal) under this clause within 30 days from the date of receipt of the written order. However, if the Contracting Officer decides that the facts justify it, the Contracting Officer may receive and act upon a proposal submitted before final payment of the contract.

(d) Failure to agree to any adjustment shall be a dispute under the Disputes clause. However, nothing in this clause shall excuse the Contractor from proceeding with the contract as changed.

(End of clause)
(R 7-901.2 1964 MAR)

5-33. Analysis of Time and Material or Labor-Hours clause. The 30-day period to submit a proposal may vary according to agency procedures. However, the contractor should protect his rights by submitting his proposal as soon as possible.

5-34. Construction Contract Clauses

FAR 52.243-4 Changes - Construction

As prescribed in 43.205(d), insert the following clause in solicitations and contracts for (a) dismantling, demolition, or removal of improvements; and (b) construction, when a fixed-price contract is contemplated and the contract amount is expected to exceed the applicable small purchase limitation in Part 13. The 30-day period may be varied according to agency procedures.

CHANGES (APR 1984)

(a) The Contracting Officer may, at any time, without notice to the sureties, if any, by written order designated or indicated to be a change order, make changes in the work within the general scope of the contract, including changes

(1) In the specifications (including drawings and designs);

(2) In the method or manner of performance of the work;

(3) In the Government-furnished facilities, equipment, materials, services, or site; or

(4) Directing acceleration in the performance of the work.

(b) Any other written or oral order (which, as used in this paragraph (b), includes direction, instruction, interpretation, or determination) from the Contracting Officer that causes a change shall be treated as a change

order under this clause; provided, that the Contractor gives the Contracting Officer written notice stating (1) the date, circumstances, and source of the order and (2) that the Contractor regards the order as a change order.

(c) Except as provided in this clause, no order, statement, or conduct of the Contracting Officer shall be treated as a change under this clause or entitle the Contractor to an equitable adjustment.

(d) If any change under this clause causes an increase or decrease in the Contractor's cost of, or the time required for, the performance of any part of the work under this contract, whether or not changed by any such order, the Contracting Officer shall make an equitable adjustment and modify the contract in writing. However, except for a "proposal for adjustment" (hereafter referred to as proposal) based on defective specifications, no proposal for any change under paragraph (b) above shall be allowed for any costs incurred more than 20 days before the Contractor gives written notice as required. In the case of defective specifications for which the Government is responsible, the equitable adjustment shall include any increased cost reasonably incurred by the Contractor in attempting to comply with the defective specifications.

(e) The Contractor must submit any proposal under this clause within 30 days after (1) receipt of a written change order under paragraph (a) above or (2) the furnishing of a written notice under paragraph (b) above, by submitting to the Contracting Officer a written statement describing the general nature and amount of the proposal, unless this period is extended by the Government. The statement of proposal for adjustment may be included in the notice under paragraph (b) above.

(f) No proposal by the Contractor for an equitable adjustment shall be allowed if asserted after final payment under this contract.

(End of clause)
(av 7-602.3 1968 FEB)
(AV 1-7.602-3)

5-35. Analysis of the Changes Clause. Analysis of the Construction contract clause as used in fixed-price contracts may best be made on a paragraph by paragraph basis.

5-36. Paragraph (a), like a counterpart provision in the clause in fixed price supply contracts, establishes the authority of the Contracting Officer to make changes within the general scope of the work. The clause makes it clear that the change may relate to any aspect of the work to be performed under the contract. The clause sets forth illustrative categories for the

making of changes which embrace changes not only in the drawings, designs and specifications, but also changes in the method and manner of performance, in the provision of sites and services, or requiring acceleration in performance. These categories are intended to be descriptive of the kind of change actions which historically have been accommodated under the Changes clauses. Deceleration actions not related to a change or unreasonable delay in the issuance of a change order were intentionally omitted since they are in the nature of a suspension, delay, or interruption covered by the Suspension of Work clause, which is a mandatory clause. Hence, it is not intended that the Changes clauses cover actions which (1) are clearly denoted as a suspension order or (2) have as a primary purpose the effecting of a suspension, delay, or interruption of the work. While the Contracting Officer is authorized to make changes in any aspect of the work itself, the clause does not authorize him to alter any of the collateral aspects of contract performance, such as are covered by the payment clauses.

5-37. Paragraph (b) of the clause (for which there is no counterpart provision in the clause in fixed-price supply contracts) concerns "constructive changes." This paragraph provides that other written or oral orders (including directions, instructions, interpretations, or determinations) from the Contracting Officer which causes a change within the general scope of the work will be treated as changes under the clause. However, as a prerequisite to the consideration of a claim based on a constructive change, the contractor must notify the Contracting Officer that he considers such order to be one directing a change in the work to be performed.

5-38. Paragraph (c) of the clause, (for which there is no counterpart provision in the clause in fixed-price supply contracts) provides that no order, statement, or conduct of the Contracting Officer shall be treated as a change, except as specifically provided for in the clause itself. With respect to constructive changes, accordingly, only those provided for in paragraph (b) may be considered under the Changes clause. This paragraph does not preclude the contractor from seeking such administrative relief as may be available under another clause contained in the contract, such as the Suspension of Work or a Government-furnished property clause. Likewise, it does not preclude the contractor from seeking judicial relief for breach of contract.

5-39. Paragraph (d), like a counterpart provision in the clause in fixed-price supply contracts, establishes the contractor's right to an equitable adjustment in situations involving the making of changes. More specifically, the paragraph states that if any change effected under the clause causes an increase in the cost of, or in the time required for, the performance of any part of the work, "whether or not changed by any such order," an equitable adjustment is to be made.

5-40. A significant revision in the clause is the adoption of additional text designed to eliminate the application of the "Rice" doctrine. This has been accomplished primarily by adding the phrases "any part of the work" and "whether or not changed". (The "Rice" doctrine is the rule derived from the case United States v. Rice, 317 US 61 (1942) which limited consideration of costs to the part of the contract which had been changed.) These now appear in the Changes clause of the general provisions for standard supply contracts. An equitable adjustment clearly encompasses the effect of a change order upon any part of the work, including delay expense; provided, of course, that such effect was the necessary and reasonable result of the change.

5-41. Except for defective specifications, the Changes clause will continue to have no application to any delay prior to the issuance of a change order. An adjustment for such types of delay, if appropriate, will be considered under the provisions of the Suspension of Work clause.

5-42. A further revision in the equitable adjustment provision in paragraph (d) has been made by reason of the recognition in the clause of constructive changes under paragraph (b). Under this revision, a contractor who seeks relief in a constructive change situation not involving defective specifications cannot recover for any costs arising more than 20 days prior to his furnishing notice as prescribed under paragraph (b). Accordingly, a cost limitation which has heretofore been prescribed for suspensions arising under the Suspension of Work clause will also be prescribed for constructive changes arising under the Changes clause. The 20 day limitation is not waivable, and costs may not be recovered contrary to this limitation.

5-43. Notwithstanding the inapplicability of the 20 day incurrence limitation to constructive change orders involving defective specification, the notice required by paragraph (b) must be given. Moreover, paragraph (d) also limits the equitable adjustment to costs reasonably incurred in attempting to comply with defective specifications. The time of the notice in relation to when the contractor becomes aware of the defect could be a factor in determining reasonableness of costs. Of course, no adjustment is intended to be allowed in connection with defective specifications unless the Government is responsible.

5-44. Paragraph (e) requires the contractor to submit to the Contracting Officer a statement setting forth the general nature and monetary extent of his claim for an equitable adjustment within 30 days after the receipt of a written change order issued under paragraph (a) or within 30 days after the furnishing to the Contracting Officer of a notice pursuant to paragraph (b). The 30-day period may be varied according to agency procedures. The paragraph also indicates that in a constructive change situation, arising under paragraph (b), the contractor may include his claim statement with this notice.

5-45. Paragraph (f) states that a claim for an equitable adjustment under the clause must be asserted prior to final payment.

5-46. Note that the disputes provision does not appear in the fixed-price demolition, dismantling or construction contract changes clause while is retained in other fixed-price contract changes clauses. The existence of an administrative or judicial remedy is established by the Disputes Act and implementing disputes clauses. Accordingly, there is no need to reiterate, in clauses covering particular aspects of the contractual agreement, the availability of that remedy. It must be emphasized that deletion of a separate disputes provision from the Changes clause (or from the Differing Site Conditions clause or the Suspension of Work clause) does not alter or diminish in any respect the applicability of the Disputes clause or the jurisdiction of administrative boards or courts, which will continue to be subject to the limitations imposed by the Disputes Act.

6-1. Constructive Changes. A major use of the Changes clause is to serve as a basis to provide a contractor with additional compensation for extra work performed on a Government contract. When work is performed that is not required by the contract and without a formal change order, it is viewed as being informally ordered by the Government or caused by Government fault, and it is a constructive change.

6-2. If the common law were applied, the theories of implied contract or breach of contract would apply. However, prior to the Contract Disputes Act of 1978, administrative procedures were developed to resolve disputes in federal contracts that precluded the use of common law theories. For that reason, the boards developed the alternate theory of constructive changes. Appeals boards can now use common law reasoning when deciding disputes under the Contract / Disputes Act but the remedy will be an equitable adjustment under the Changes clause.

6-3. Reasons for this preference include the large body of precedent relating to the computation of equitable adjustment, the broad definition of change under the constructive changes doctrine which provides freedom in program implementation through the use of the changes clauses, and the contractor is required, under the constructive changes doctrine, to continue work pending the resolution of his dispute and comply with the notice requirements in the Changes clause.

6-4. The Board analyzed constructive changes in Industrial Research Associates, Inc., DCAB WB-5, 68-1 BCA ¶ 7069 (1968) at 32,685-86:

> As we see it, the constructive changes doctrine is made up of two elements -- the "change" element and the "order" element. To find the change element we must examine the

actual performance to see whether it went beyond the minimum standards demanded by the terms of the contract. But, this is not the end of the matter.

The "order" element also is a necessary ingredient in the constructive change concept. To be compensable under the changes clause, the change must be one that the Government ordered the contractor to make. The Government's representative, by his words or his deeds, must require the contractor to perform work which is not a necessary part of his contract. This is something which differs from advice, comments, suggestions, or opinions which Government engineering or technical personnel frequently offer to a contractor's employees.

6-5. This is a narrow analysis since Government fault, prior to or during contract performance, may provide the "order" element. Therefore, a better statement would be that a constructive change requires work beyond the contract requirements in addition to either an "order" or "fault" by the Government.

6-6. There are four main areas of constructive changes which represent the main use of the constructive changes doctrine in Government contracts. They are:1. disagreements between parties over the contract requirements; 2 defective specifications and Government non-disclosure of information; 3. acceleration; and, 4. failure of the Government to cooperate during performance.

6-7. 1. Disagreement between parties. This first major category involves work which "could have been" ordered as a change. It includes Government orders, suggestions, interpretation of specifications, Government rejection of a method that is permitted in the contract and "orders" of authorized representatives of the Contracting Officer. Refer to discussion of Authority at 2-1, supra. Other areas of disagreement occur in work outside of the Changes clause. These areas include the improper exercise of options or withholding of payments, Government ordered change in an accounting system and unauthorized disclosure of technical data.

6-8. (2) Defective Specifications. This second category of constructive change comes into play when the Government misleads the contractor by the information it provides and the contractor, in attempting to work in conformance with this information, incurs additional expense. The courts and boards satisfy the order element by finding the Government at fault by breaching its implied duty to provide accurate information. There is a presumption that specifications provided by the Government are correct and when the contractor follows them the result will be a product that meets the contract requirements. When the specifications are defective and the contractor incurred additional expense thorough his reliance on them, a constructive change exists.

6-9. (3) Acceleration. The third category of constructive changes involves the speeding up of contract work in order to complete performance earlier than the date called for in the contract. A contractor may accelerate his performance for his own purpose; these acceleration costs are not recoverable from the Government. When the Government orders acceleration, it is compensable. Most of these cases involve a contractor with excusable delays which would entitle him to an extension of the contract schedule. If the Government denies the claim for extra days, it has the same effect as an acceleration of the schedule.

6-10. There are five elements of constructive acceleration.

1. Excusable delay. The existence of a delay that can and should be excused is primary.

2. The Contracting Officer must have knowledge of the excusable delay at the time of acceleration.

3. An act or a communication that can be reasonably interpreted as an order to accelerate is the third element.

4. The contractor must give notice that that the order is constructive change (this is a requirement under the construction contract Changes clause).

5. The final element is the incurrence of additional costs of accelerated effort.

When all of these elements have been met, the acceleration is a constructive change and an equitable adjustment will follow.

6-11. (4) Failure to Cooperate. The fourth category of constructive changes involves Government action or inaction. The Government has a duty not to impede, hinder or interfere with the contractor's performance of the contract. However, the notice requirement must be met. In Cameo Bronze, Inc., GSBCA 3646, 73-2 BCA 10,135, motion for reconsid. denied, 73-2 BCA 10,365 (1973) the board said that lack of notice would be fatal to a constructive change claim based on failure to allow adequate access to the worksite. An important reason for the notice requirement in these cases is to preclude the contractor from finding its own solutions to performance problems and charging the Government for the increased costs without allowing the Government to solve the problem or approve the contractor" solution.

6-12. The notice requirement that has been referred to is stated in several clauses. The Notification of Changes Clause which follows is representative of these clauses. Section (b) provides detailed list of the information the contractor must provide.

6-13. FAR 52.243-7 Notification of Changes.

As prescribed in 43.106, the contracting officer may insert a clause substantially the same as the following in solicitations and contracts. The clause is available for use primarily in negotiated research and development or supply contracts for the acquisition of major weapon systems or principal subsystems. If the contract amount is expected to be less than $1,000,000, the clause shall not used, unless the contracting officer anticipates that situations will arise that may result in a contractor alleging that the Government has effected changes other than those identified as such in writing and signed by the contracting officer.

NOTIFICATION OF CHANGES (APR 1984)

(a) Definitions. "Contracting Officer," as used in this clause, does not include any representative of the Contracting Officer. "Specifically authorized representative (SAR)," as used in this clause, means any person the Contracting Officer has so designed by written notice (a copy of which shall be provided to the Contractor) which shall refer to this subparagraph and shall be issued to the designated representative before the SAR exercises such authority.

(b) Notice. The primary purpose of this clause is to obtain prompt reporting of Government conduct that the Contractor considers to constitute a change to this contract. Except for changes identified as such in writing and signed by the Contracting Officer, the Contractor shall notify the Administrative Contracting Officer in writing promptly, within....(to be negotiated) calendar days from the date that the Contractor identifies any Government conduct (including actions, inactions, and written or oral communications) that the Contractor regards as a change to the contract terms and conditions. On the basis of the most accurate information available to the Contractor, the notice shall state-

(1) The date, nature, and circumstances of the conduct regarded as a change;

(2) The name, function, and activity of each Government individual and Contractor official or employee involved in or knowledgeable about such conduct;

(3) The identification of any documents and the substance of any oral communication involved in such conduct;

(4) In the instance of alleged acceleration of scheduled performance or delivery, the basis upon which it arose;

(5) The particular elements of contract performance for which the Contractor may seek an equitable adjustment under this clause, including-

(i) What contract line items have been or may be affected by the alleged change;

(ii) What labor or materials or both have been or may be added, deleted, or wasted by the alleged change;

(iii) To the extent practicable, what delay and disruption in the manner and sequence of performance and effect on continued performance have been or may be caused by the alleged change;

(iv) What adjustments to contract price, delivery schedule, and other provisions affected by the alleged change are estimated; and

(6) The Contractor's estimate of the time by which the Government must respond to the Contractor's notice to minimize cost, delay or disruption of performance.

(c) Continued performance. Following submission of the notice required by (b) above, the Contractor shall diligently continue performance of this contract to the maximum extent possible in accordance with its terms and conditions as construed by the Contractor, unless the notice reports a direction of the Contracting Officer or a communication from a SAR of the Contracting Officer, in either of which events the Contractor shall continue performance; provided, however, that if the Contractor regards the direction or communication as a change as described in (b) above, notice shall be given in the manner provided. All directions, communications, interpretations, orders and similar actions of the SAR shall be reduced to writing promptly and copies furnished to the Contractor and to the Contracting Officer. The Contracting Officer shall promptly countermand any action which exceeds the authority of the SAR.

(d) Government response. The Contracting Officer shall promptly, within.... (to be negotiated) calendar days after receipt of notice, respond to the notice in writing. In responding the Contracting Officer shall either-

(1) Confirm that the conduct of which the Contractor gave notice constitutes a change and when necessary direct the mode of further performance,

(2) Countermand any communication regarded as a change;

(3) Deny that the conduct of which the Contractor gave notice constitutes a change and when necessary direct the mode of further performance; or

(4) In the event the Contractor's notice information is inadequate to make a decision under (1), (2), or (3) above, advise the Contractor what additional information is

required, and establish the date by which it should be furnished and the date thereafter by which the Government will respond.

(e) Equitable adjustments. (1) If the Contracting Officer confirms that Government conduct effected a change as alleged by the Contractor, and the conduct causes an increase or decrease in the Contractor's cost of, or the time required for, performance of any part of the work under this contract, whether changed or not changed by such conduct, an equitable adjustment shall be made-

(i) In the contract price or delivery schedule or both; and

(ii) In such other provisions of the contract as may be affected.

(2) The contract shall be modified in writing accordingly. In the case of drawings, designs or specifications which are defective and for which the Government is responsible, the equitable adjustment shall include the cost and time extension for delay reasonably incurred by the Contractor in attempting to comply with the defective drawings, designs or specifications before the Contractor identified, or reasonably should have identified, such defect. When the cost of property made obsolete or excess as a result of a change confirmed by the Contracting Officer under this clause is included in the equitable adjustment, the Contracting Officer shall have the right to prescribe the manner of disposition of the property. The equitable adjustment shall not include increased costs or time extensions for delay resulting from the Contractor's failure too provide notice or to continue performance as provided, respectively, in (b) and (c) above.

NOTE: The phrases "contract price" and "cost" wherever they appear in the clause, may be appropriately modified to apply to cost-reimbursement or incentive contracts, or to combinations thereof.

(End of clause)
(AV 7-104.86)

7-1. Modifications other than under Changes Clauses. Although most modifications fall under the category of Changes, many are generated under other contract clauses, including "Differing Site Conditions," "Government Furnished Property" the Default clause, partial termination for convenience of the Government and the settlement of disputes by agreement. Many other types of modifications occur. Some of these modifications are presented in the following sections.

7-2. Differing Site Conditions Clause. (Mandatory)

This clause is required in fixed-price construction, demolition, dismantling and "removal of improvements" contracts exceeding small purchase limitations and, at the Contracting Officer's discretion, permissive within such limitations. It reads as follows.

FAR 52.236-2. Differing Site Conditions

As prescribed in 36.502. insert the following clause in solicitations and contracts when a fixed-price dismantling, demolition, or removal of improvements contract is contemplated and the contract amount is expected to exceed the small purchase limitation. The contracting officer may insert the clause in solicitations and contracts when a fixed-price construction or a fixed price contract for dismantling, demolition, or removal of improvements is contemplated and the contract amount is expected to be within the small purchase limitation.

DIFFERING SITE CONDITIONS
(APR 1984)

(a) The Contractor shall promptly, and before the conditions are disturbed, give a written notice to the Contracting Officer of (1) subsurface or latent physical conditions at the site which differ materially from those indicated in this contract, or (2) unknown physical conditions at the site, of an unusual nature, which differ materially from those ordinarily encountered and generally recognized as inhering in work of the character provided for in the contract.

(b) The Contracting Officer shall investigate the site conditions promptly after receiving the notice. If the conditions do materially so differ and cause an increase or decrease in the Contractor's cost of or the time required for performing any part of the work under this contract, whether or not changed as a result of the conditions an equitable adjustment shall be made under this clause and the contract modified in writing accordingly.

(c) No request by the Contractor for an

equitable adjustment to the contract under this clause shall be allowed, unless the Contractor has given the written notice required: provided, that the time prescribed in (a) above for giving written notice may be extended by the Contracting Officer.

(d) No request by the Contractor for an equitable adjustment to the contract for differing site conditions shall be allowed if made after final payment under this contract.

7-3. A clause of this type is necessary in fixed price construction contracts where the contractor may encounter unknown or unanticipated physical conditions at the site of the project which may either delay performance or increase the costs, or both. One of the purposes of the clause is to eliminate the tendency of contractors to submit nflated bid prices based on the worst physical conditions that might be encountered, by providing simple and quick relief for changed conditions. To assure close pricing and truly competitive bids, the Government assumes liability for what is described as naturally different or unknown physical conditions.

7-4. Other than the change in title, the major difference in this clause and a previous "Changed Conditions" clause is the addition of the phrases, "any part of the work" and "whether or not changed." These phrases were added to conform with similar provisions of the revised Changes clause for construction contracts. This clause also provides for downward as well as upward adjustment in contract price and completion time, a point often overlooked.

7-5. Changes in Specifications and Drawing. Some changes in specifications and drawings are not obviously within the scope of the clause. In the situation where an honest misinterpretation of the meaning or extent of the specifications occurs, the insistence by the Government on specifications not contained in the contract presents a problem. Ordinarily, where the misinterpretation is by the Government, the requirement that the contractor proceed on different specifications than those contained in the contract places the changes within the scope of the Changes clause and any additional cost to the contract is compensable. On the other hand, where the contractor misinterprets the specifications, a different result usually follows and the change is not compensable under the equitable adjustment provision of the Changes clause. An exception is frequently made where the contractor's misinterpretation is reasonable under the circumstances.

7-6. Frequently the change in the specifications occurs when material or procedures are substituted. In the majority of cases, a change in either materials or procedures is a change falling within the scope of the Changes clauses and is

compensable where equity requires adjustment. When the contractor requests a deviation in either material supply or procedure, an approval by an authorized Government representative is a change under the Changes clause.

7-7. Changes in Performance. Government orders to change either the method of packing or shipping items supplied under the contract are such changes where the contractor sustains increased costs. The same reasoning would apply where the place of delivery is changed by Government order and the contractor suffers additional expense.

7-8. Delays and Suspension of Work. Government contracting, as with any commercial undertaking, may experience delays and suspension of work prior to accomplishing a contract objective. This section discusses how these problems may come about and how they may be treated once they are recognized.

7-9. The Problem of Delays. A difficult problem in Government contracts is concerned with those delays in contract performance resulting from some act or failure to act on the part of the Government and its relationship to contract modifications. Some of these delays are the result of the Government's failure to take timely action, such as delays in furnishing drawings and specifications, delays in ordering changes, or delays in furnishing Government property. Other delays may be directed by the Government in such cases as "Suspension of Work" or "Stop Work Orders".

7-10. There are many clauses in Government contracts that treat the problem of delays. Most of them recognize and provide for a time adjustment or an extension of time for performance of the contract work as a result of Government caused delays. Not all of these clauses provide for a monetary adjustment because of such delays. If there is no remedy for delayed performance or increased cost of performance under the terms of the contract, the contractor must look to the courts for relief. In general, however, the courts have held that the Government is not liable for increased costs from delays to the contractor's performance unless there was an element of negligence on the part of the Government or unless the delays were unreasonable.

7-11. An example of a court ruling on delays can be seen in Magoba Construction Co. v. United States, 99 Ct. Cl. 662(1943) where the court held that the Government had delayed the contractor in the process of ordering a number of changes but that the delay was reasonable under the terms of the Changes clause and hence there was no breach of contract. In Chouteau v. United States, 95 US 61 (1877), the court interpreted the Changes clause as contemplating some delay in ordering changes on a project when both parties knew there would be changes during the course of performance, and held that the Government was not liable for the increased cost incurred by the contractor because of reasonable delay by the Government in ordering changes.

7-12. The courts have emphasized that the basic question is the reasonableness of the delay and that the reasonableness must be determined on the basis of the facts of each contract. The rule seems to be firmly established now that an unreasonable delay in issuing changes is a breach of contract by the Government. In reviewing cases involving delay or failure to furnish material or Government property the courts have looked primarily to whether the Government has made a reasonable effort to furnish the property. In the cases holding for the contractor, there has been some implication that the Government did not act with proper diligence. This would lead to the conclusion that compensation for delays will be allowed only when due to the fault or negligence of the Government.

7-13. Government Delay of Work Clause. This clause is required in fixed-price supply contracts for other than commercial or modified-commercial items. It is optional for fixed-price service contracts, or for commercial or modified-commercial supplies. The clause provides for equitable adjustment for delays and interruptions caused by acts, or failures to act, of the Contracting Officer not otherwise specifically provided for in the contract. The clause charges the Contracting Officer with the affirmative duty to take whatever appropriate action is necessary to end or otherwise dispose of unordered delays or interruptions in the work. The clause does not authorize the Contracting Officer to delay, suspend, or interrupt the work, nor can it be used as a basis for such actions. The clause is quoted below:

7-14. FAR 52.212-15

GOVERNMENT DELAY OF WORK
(APR 1984)

(1)(a) If the performance of all or any part of the work of this contract is delayed or interrupted (1) by an act of the Contracting Officer in the administration of this contract that is not expressly or impliedly authorized by this contract, if not specified, an adjustment (excluding profit) shall be made for any increase in the cost of performance of this contract caused by the delay or interruption and the contract shall be modified in writing accordingly. Adjustment shall also be made in the delivery or performance dates and any other contractual term or condition affected by the delay or interruption. However, no adjustment shall be made under this clause for any delay or interruption to the extent that performance would have been delayed or interrupted by any other cause, including the fault or

negligence of the Contractor, or for which an adjustment is provided or excluded under any other term or condition of this contract.
(b) A claim under this clause shall not be allowed (1) for any costs incurred more than 20 days before the Contractor shall have notified the Contracting Officer in writing of the act or failure to act involved, and (2) unless the claim, in an amount stated, is asserted in writing as soon as practicable after the termination of the delay or interruption, but not later than the day of final payment under the contract.

7-15. Suspension of Work Clause. A clause similar to the Government Delay in Work clause is mandatory for fixed-price construction and architect-engineer contracts. A significant difference, is that the Suspension of Work clause expressly provides for suspension, delay, or interruption of the work at the Government's convenience. It also provides for constructive suspension, delay or interruption by the Contracting Officer's failure to act where the contract requires such actions. As in other "delay clauses," the clause establishes machinery for administrative settlement on a fair and speedy basis where the contract does not otherwise specifically provide for equitable adjustment for delays and interruptions. The clause is quoted below:

FAR 52.212-12.

SUSPENSION OF WORK
(APR 1984)

(a) The Contracting Officer may order the Contractor, in writing, to suspend, delay, or interrupt all or any part of the work of this contract for the period of time that the Contracting Officer determines appropriate for the convenience of the Government.

(b) If the performance of all or any part of the work is for an unreasonable period of time, suspended, delayed, or interrupted (1) by an act of the Contracting Officer in the administration of this contract, or (2) by the Contracting Officer's failure to act within the time specified in this contract (or within a reasonable time if not specified), an adjustment shall be made for any increase in the cost of performance of this contract (exlcuding Profit) necessarily caused by the unreasonable suspension, delay or interruption, and the contract modified in writing accordingly. However, no adjustment shall be made under this clause for any suspension, delay, or interruption to the extent that performance would have been so suspended, delayed, or interrupted by any other cause, including the fault or

negligence of the Contractor, or for which an equitable adjustment is provided for or excluded under any other term or condition of this contract.

(c) A claim under this clause shall not be allowed (1) for any costs incurred more than 20 days before the Contractor shall have notified the Contracting Officer in writing of the act or failure to act involved (but this requirement shall not apply as to a claim resulting from a suspension order), and (2) unless the claim, in an amount stated, is asserted in writing as soon as practicable after the termination of the suspension, delay, or interruption, but not later than the date of final payment under the contract.

7-16. The provision for expressly ordering a suspension, delay, or interruption is intended for use under strict supervision, and for as limited a period as practicable. Such orders can result in the Government incurring costs by reason of standby time. If the Contracting Officer orders the contractor to stop work in a situation in which no delay amounting to a breach of contract occurs, the Government has given away one of its rights because the order is very likely to be construed as an actual suspension of work order. If, on the other hand, the Government has a contractual duty to act, failure to act may be construed as a constructive suspension of work. The Government representative must therefore be aware of his rights and duties under the contract and must carefully consider them before taking any action that will affect the contractor's time for performance.

7-17. The interpretation by the courts that reasonable delays are to be expected under the contract creates a dilemma for the Contracting Officer. If he issues an actual order to suspend the work, the contractor may take the order as an admission that the entire period subsequent to the order is unreasonable and that he is entitled to compensation for the full period of the suspension. E.V. Lane Corp. ASBCA No. 7232 (1962). On the other hand, if the Contracting Officer recognizes an actual need for stopping work, he should not allow the contractor to waste Government funds by continuing to work.

7-18. Concurrent Delays. A feature of the clause that deserves special mention is that pertaining to concurrent delays. It states that no adjustment shall be made for suspension, delay or interruption to the extent that performance would have been suspended, delayed, or interrupted by any other cause, including the fault or negligence of the contractor. The determination of what delays warrant adjustment is a job for both the purchasing officer and the contract administration officer working together. Technical personnel along with production and contracting representative must assist in deciding which delays should be recognized. Program Evaluation Review Techniques and Critical Path Charts are use full when a large number of recurring delays are involved.

7-19. Delays Not Covered by Contract. Delay claims covered by contract clauses simply provide an administrative handling of what would otherwise be a contractor's claim for breach of contract by the Government. But does the Contracting Officer have authority to settle, by supplemental agreement, delay claims where no such clauses are included in the contract? The Court of Claims in the 1963 case of Cannon Construction Co. v. U.S., 319 F.2d 173, specifically approved a settlement of a breach claim, citing the implied authority of the Contracting Office to settle claims arising out of performance and stating:

> Significantly, plainiffs have cited us no cases where this court has invalidated, on the ground of lack of authority any agreement made by the Contracting Officer in the settlement of a claim for damages for breach of contract. On the contrary we have held on numerous occasions that compromise settlements were valid and binding on both parties.

7-20. The agreement, the court found, was an accord and satisfaction of the claim. This decision was followed by the same court in Brock & Blevins Co., Inc., v. U.S., 170 Ct. Cl. 52;343 F.2d 951 (1965) and has not been overruled. The Comptroller General, however, as recently as December 22, 1964, emphatically stated that Contracting Officers do not have authority to settle breach claims (B-155343), citing Cramp v. United States, 216 US 494 (1910) among other cases, which so held, noting also that procurement appropriations are not available to pay damages. The Comptroller General reserves to himself (under the claims settling authority of section 71 of the Budget and Accounting Act of 1921, cited as 31 USC 71) the decision as to whether the contractor should be paid under these circumstances. Of course, the contractor could also resort to the courts in a suit for breach of contract. Although, as noted above, the former Court of Claims has upheld supplemental agreements disposing of these claims, the circumspect Contracting Officer will be considerably deterred by the Comptroller General's steadfast refusal to follow these court decisions.

7-21. Another approach would be to retreat to the contract document itself and insert language (with the contractor's approval) calling for administrative disposition of such claims generally, or perhaps insert belatedly a "Government Delay of Work" or "Suspension of Work" clause.

7-22. The Armed Services Board of Contract Appeals (ASBCA) has also recognized a letter from the Contracting Officer ordering work stoppage and calling for an equitable adjustment as providing an administrative alternative to suit where no clause was present. Blount Brothers Construction Co., ASBCA NO. 5267,60-2 BCA 2664.

7-23. Stop Work Orders. Since fixed-price supply and research and development contracts no longer require a Suspension of Work

clause, an "additional clause" may be used where a work stoppage is desirable for reasons such as realignment of programs or advancements in the state of the art. The use of Stop Work Orders is carefully circumscribed, however. For instance, such an order may be used pending a decision to terminate for convenience but it cannot used pending a decision to terminate for default. Nor can a Stop Work Order be used in lieu of a termination notice after decision to terminate has been made. Since Stop Work Orders may result in standby costs, prior approval of their insurance and cancellation is required at a level above the Contracting Officer. The clause is quoted below:

7-24 FAR 52.21213

STOP WORK ORDER
(APR 1984)

(a) The Contracting Officer may, at any time, by written order to the Contractor, require the Contractor to stop all, or any part, of the work called for by this contract for a period of 90 days after the order is delivered to the Contractor, and for any further period to which the parties may agree. The order shall be specifically identified as a stop-work order issued under this clause. Upon receipt of the order, the Contractor shall immediately comply with its terms and take all reasonable steps to minimize the incurrence of costs allocable to the work covered by the order during the period of work stoppage. Within a period of 90 days after a stop-work is delivered to the Contractor, or within any extension of that period to which the parties shall have agree, the Contracting Officer shall either -

(1) Cancel the stop-work order: or

(2) Terminate the work covered by the order as provided in the Default, or the Termination for Convenience of the Government, clause of this contract.

(b) If a stop-work order issued under this clause is canceled or the period of the order or any extension thereof expires, the Contractor shall resume work. The Contracting Officer shall make an equitable adjustment in the delivery schedule or contract price, or both, and the contract shall be modified, in writing, accordingly, if

(1) The stop-work order results in an increase in the time required for, or in the Contractor's cost property allocable to the performance of any part of this contract; and

(2) The Contractor asserts a claim for the adjustment within 30 days after the end of the period of work stoppage: provided, that, if the Contracting Officer decides the facts justify the action, the Contracting Officer may receive and

act upon the claim asserted at any time before final payment under this contract.

(c) If a stop-work order is not canceled and the work covered by the order is terminated for the convenience of the Government the Contracting Officer shall allow reasonable costs resulting from the stop-work order in arriving at the termination settlement.

This clause also has an alternate provision, to be used in Cost-Reimbursement Contracts.

7-25. Acceleration. Acceleration involves contractual speedups. They may occur in a number of ways, but the most common are (1) by the Government representative requiring delivery in advance of that specified in the contract, or (2) by the Government representative adding something in the way of additional performance, but failing to extend the delivery date in proportion to the additional work to be performed. Orders to speed up performance or perform by an earlier date than that required by the contract are unique in that they affect the time of performance rather than the work, and, therefore, are not normal changes to a contract. Also acceleration orders can be classified as being either actual orders or constructive orders.

7-26. Actual Acceleration Orders. If the clause specifically provides for changes in the time of completion or delivery, the parties have created the right in the Contracting Officer to order an acceleration. Such cases, as might be expected, are comparatively rare.

7-27. Specifications are always subject to change under the Changes clause. If the specifications contain the completion or delivery schedule, an acceleration order may be allowed as a change under the Changes clause. This has occurred principally in construction contracts. Even where the schedule is not in the specification and the Changes clause does not cover changes in the schedule, the Board of Contract Appeals has allowed acceleration under the Changes clause. In Ensign-Bickford Co., ASBCA NO. 6214, the Board accepted the fact that a direct acceleration order falls within the Changes clause even though the clause contains no such specific provisions. It should be noted however, in this case both parties agreed to the order and the dispute was over the amount of the equitable adjustment.

7-28. The obvious answer, in the event an acceleration is required and no provision is present in the Changes clause, is to negotiate a bilateral agreement, adjusting the schedule. This permits the contractor to refuse to accelerate or to treat the order as a breach of contract. In either case, by unilateral order or bilateral agreement, the contractor is entitled to an equitable adjustment if the acceleration causes an increase in his costs.

7-29. Variations in Quantity. Variations in quantity of items, either a shortage or an overage, may be due to such factors as mass production and machine-packaging of modern manufacture. Thus, in some cases, variations in quantity may be a normal incident of production. The FAR covers several possible variations in quantity.

7-30. The Contracting Officer shall insert the following clause in solicitations and contracts where a fixed-price supply contract or a services contract involving the furnishing of supplies is contemplated (52.212-9):

VARIATION IN QUANTITY
(APR 1984)

(a) A variation in the quantity of any item called for by this contract will not be accepted unless the variation has been caused by conditions of loading, shipping, or packaging or allowances in manufacturing processes, and then only to the extent, if any, specified in paragraph (b) below.

(b) The permissible variation shall be limited to:

( ) Percent increase (Contracting Officer insert percentage)

( ) Percent decrease (Contracting Officer insert percentage)

This increase or decrease shall apply to ( ).*

* Contracting Officer shall insert in the blank the designation(s) to which the percentages apply, such as (1) the total contract quantity, (2) item 1 only, (3) each quantity specified in the delivery schedule, (4) the total item quantity for each destination, or (5) the total quantity of each item without regard to destination.

7-31. Quantities in excess of contract requirements, including any permissible variation in quantity, will be treated as being delivered for the convenience of the Contractor. The Government may retain such excess quantities up to $100 in value without payment therefor and the Contractor waives all title or interest therein. Quantities in excess of $100 may be returned at the Contractor's expense or retained and paid for at the contract price. FAR 52.212-10, Delivery of Excess Quantities of $100 or Less (APR 1984) covers these circumstances.

7-32. Variations of Quantity-Construction Contracts. Where a fixed-price construction contract authorizing a variation in the estimated quantity of unit-priced items is contemplated, the clause

FAR 52.212-11 is mandated:

VARIATION OF QUANTITY
(APR 1984)

If the quantity of a unit-priced item in this contract is an estimated quantity and the actual quantity of the unit-price d item varies more than 15 percent above or below the estimated quantity, an equitable adjustment in the contract price shall be made upon demand of either party. The equitable adjustment shall be based upon any increase or decrease in costs due solely to the variation above 115 percent or below 85 percent of the estimated quantity. If the quantity variation is such as to cause an increase in there time necessary for completion, the Contractor may request, in writing an extension of time to be received by the Contracting Officer within 10 days from the beginning of the delay or within such further period as may be granted by the Contracting Officer before the date of final settlement of the contract. Upon the receipt of a written request for an extension the Contracting Officer shall ascertain the facts and make an adjustment for

7-33. Engineering Change Proposals. In addition to the unilateral changes the Government makes under the clause, the Contracting Officer may request the contractor to submit an Engineering Change Proposal (ECP). It is important that the ECP sets forth a "not to exceed" price and delivery adjustment or a "not less than" price and delivery adjustment. If the Government orders the ECP, the equitable increase shall not exceed the "not to exceed" amount' the equitable decrease shall not not be less than the "not less than" amount.

7-34. The Engineering Change Proposals clause requires the contractor to prepare the ECP. However, the clause is silent on whether the work falls under the Changes clause for the purpose of equitable adjustment. The Army Procurement Procedure 26-205 requires compensation when the Contracting Officer orders the preparation of an ECP, and the work is usually treated as a change.

7-35. The contractor can initiate his own ECP without a request from the Government. The Contracting Officer must carefully evaluate each ECP calling in whatever technical experts are necessary to ascertain whether the change would benefit the Government or only benefit the contractor. The contractor can also request the Government issue a change order by submitting a Value Engineering Change Proposal.

7-36. Value Engineering Changes. Another form of contract modification achieved by either a change order or a supplemental agreement is the Value Engineering change. This is a procurement technique that was developed to encourage the submissio of cost reducing change proposals by promising the contractor a share of the savings.

7-37. The Department of Defense first adopted Value Engineering regulations in the early 1960s. After a number of revisions, uniform regulations and clauses were adopted in 1977 by DOD and GSA for use by all federal agencies. The clauses have been further revised in the FAR. Because of this frequent revision, case holdings concerning early clauses may not be relevant to the clauses currently in use. Therefore, it is essential to identify the precise language the court is interpreting.

7-38. Value Engineering Clauses. There are two types of Value Engineering clauses, one e is an incentive clause that encourages contractors to voluntarily develop, prepare, and submit Value Engineering Change Proposals (VECPs). If the VECP is accepted by the Government the Contractor will receive a relatively large shares of the sayings and will recover development and implementation costs. This clause will be found most often in a contract where the contractor is working to detailed specifications and is likely to identify cost saving measures.

7-39. The other type of Value Engineering clause requires the contractor to have a specific value engineering program. The contractor's share of the savings is smaller because his value engineering activities are priced into the contract. This clause is found primarily in contracts for the development of new items or where the contract specifications are broad and the Government anticipates that considerable cost savings will be possible during performance of the contract.

7-40. Value Engineering clauses must be included in supply and service contracts for $100,000 or more and construction contracts for $100,000 or more.

7-41. Interpretation of the clauses. The courts and boards have frequently indicated that provisions of the Value Engineering Incentive clause be liberally interpreted in favor of the contractor. Dravo Corp., v. United States, 202 Ct. Cl. 500, 480 F.2d 1331 (1973).

7-42. The Contracting Officer plays a major role in value engineering. His decision to accept or reject, in whole or in part, any VEPC and his decision as to which share rates apply are final and not subject to the Disputes clause or to litigation under the Contract Disputes Act. FAR 52.248-1 (j)

7-43. Unsolicited Value Engineering Proposals. There is no provision, under current regulations, for accepting unsolicited value engineering proposals without a contract containing a Value Engineering Clause. The Court of Claims held that when a value engineering proposal is submitted without a contract clause, there is no statutory authority to purchase "suggestions'. Grismac Corp. v. United States, 214 Ct. Cl. 29, 556 F. 2d 494 (1977).

EQUITABLE ADJUSTMENT

This chapter will discuss the factors involved in measuring equitable adjustments. Throughout the chapter on Modifications we have referred to equitable adjustment; it is an adjustment to an existing contract, changing price and/or delivery schedule. There may also be adjustments to other provisions of the contract if they are affected by the changes. Adjustments other than price are frequently negotiated without much difficulty. However, adjustments to price are often troublesome. This is an area that has been considered by boards and courts over the years. Our discussion will deal primarily with the pricing aspects of equitable adjustments.

We begin with an overview of contractor and Government actions from modification through settlement. The body of the chapter is identical to the Government Contract Law text and includes the history of equitable adjustments, a detailed discussion of five methods of pricing a modification, types of costs, and profit.

Overview after reading the chapter on modifications, it is clear that if the contract requirements or specifications are not providing or working toward the item or service the Government wants to procure, a modification is necessary. The contractor will then claim any extra costs from the Government and seek an equitable adjustment. The contractor must file a claim with supporting documentation which will be evaluated by the Government. This is a right of the contractor; it is not adversarial in nature.

The contractor should notify the Government of a claim as soon as possible. This frequently shortens the time period before resolution and settlement as both parties' personnel are available with fresh memories of the change. This kind of quick action is possible only when the contractor has been scrupulous in tracking the project and in record-keeping. If the information necessary to substantiate the claim is readily available and does not have to be researched or generated, the contractor can proceed quickly. The contractor bears complete responsibility for the content of his claim.

The contractor will provide a statement of the original work, a description of the change, a specific description of what the change entailed (preparation requirements, man hours, or extra labor, extra materials and unexpected costs that are directly related). A detailed schedule of costs which translates all of the above into dollars is presented as a separate statement. In addition, the claim should present the contractor's theory under which he believes he can recover.

The Government will be looking for a clear statement of the claim with supporting documentation. By its title, equitable adjustment seeks to do equity and carry out the policy of procuring at a fair price. When a contractor provides good documentation and a reasonable theory for recovery a rapid settlement is quite likely. If settlement can not be reached, the contractor has a remedy under the Disputes Clause. Both parties will usually prefer to settle, even if it means a compromise (within an acceptable scale), rather than litigate for breach of contract. Litigation is a long and expensive route and if the Government loses it is liable for the contractors' claims that are upheld plus the interest that has accrued. Settlement is possible until the board or court hands down its decision.

1. HISTORICAL PERSPECTIVE

1-1. Equitable adjustment is derivative of two early doctrines which acted as the basis of contract compensation. These early doctrines are explained in the following paragraphs.

1-2. Common Law Background. Under the common law, one was compensated for goods sold and delivered or services rendered under the equitable doctrines of "quantum meruit" or "quantum valebat".

1-3. Quantum Meruit. Literally translated, quantum meruit means "as much as he has deserved." The doctrine applied to situations where a person was employed to do work for another without an agreement as to compensation. In such case the law would imply a promise from the employer to the workman that he would pay him "as much as he may merit." Under the common law pleading of assumpsit (simple contract), the workman would aver a promise to pay what he reasonably deserved and then aver that his effort was worth a certain sum of money.

1-4. Quantum Valebat. Quantum valebat, pertained to goods. The term means "as much as it was worth." When goods were sold without specifying a price, the law implied a promise by the buyer to pay the seller "as much as they were worth." The declaration (pleading) would then aver that the buyer promised to pay as much as the goods were worth, and that the goods were worth a certain sum which the buyer refused to pay.

1-5. These doctrines have been incorporated into the substantive law, and recovery on the theory of implied contract may still be made under either doctrine in present jurisdictions. Early Government contracts did not contain "Changes" clauses. When changes were ordered by an authorized agent of the Government, acting within the scope of his authority, compensation was due the contractor under the common law.

1-6. The earliest "Changes" clause calling for what is now known as an "equitable adjustment" appeared in a contract for the

construction of an iron-clad vessel in 1863. A clause in the contract provided that "alterations" might be made while the vessel was under construction. In straightforward language the clause stipulated that if the alterations "caused extra expense, that should be paid for, if they effected a reduction in cost, that should be subtracted from the contract price." The changes were inevitable and the Court of Claims had occasion to consider the claims under that contract.

1-7. Various "Changes" clauses used by the Departments of the Government were standardized by the Treasury Department, and since 1921 have been published in standard forms of contracts for use by the Executive Branch. The standard clauses require an "equitable adjustment" in the event of changes made within the scope of a contract.

1-8. Equitable adjustment is a two-way street. Depending on the circumstances, either the contractor or the Government may be entitled to an adjustment in price, period of performance, or both. It should be noted that both parties may be entitled to some adjustment, depending on the nature of the change. In such case, the party suffering the final detriment, by the preponderance of proof, will be due an adjustment from the party finally benefiting. Or, as it often happens, the interchange of the benefit and detriment of a change may result in a "wash-out", wherein there is neither a gain nor a loss in the respective positions of the parties.

1-9. Entitlement is a prerequisite of equitable adjustment. Before the issue of quantum can arise, the conditions precedent to an equitable adjustment must exist. For example, is the change within the scope of the Changes (or other applicable) clause? Was the change made in fact? Were the procedural formalities of the clause observed? Is recovery precluded by "laches" or "estoppel"?

1-10. The concept of equitable adjustment closely approximates the legal doctrine of damages. In the case of Hadley v. Baxendale, (9 Exchequer 341 (1854)), it was held that damages for breach of contract "such as may fairly and reasonably be considered arising naturally, i.e., according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties at the time they made the contract, as the probable breach of it." The law refers to such damages as "direct". Those not arising naturally, or not having been "in the comtemplation of both parties", are generally referred to as "consequential" damages. Direct damages are recoverable; consequential damages, as a rule, are not recoverable. The principle of the rule of Hadley v. Baxendale has been applied to equitable adjustments in distinguishing the costs arising therefrom, as we shall see later in this chapter.

1-11. Finally, be aware that there is no ultimate correct technique for pricing-out a change. In the absence of determinative guidelines, the pricing of changes has been a recurrent problem. As a result of various Board of Contract Appeals and court decisions, certain rules have emerged which indicate that, in those particular circumstances, a given method is preferable to another. However, there appears to be no general agreement as to the basic method or approach that is to be used in pricing changes. Two schools of thought exist in this respect: the Reasonable Value or "objective" approach versus the Specific Cost or "subjective" approach. Currently, the prevailing method appears to be a combination of the two.

2. MEASUREMENT

2-1. The incorporation of the word "equitable" in the various Changes clauses purports the connotation of equity to both the Government and the contractor. But what is "equitable" is generally a question of fact, which boils down to being a question of judgment. Judgments are normally substantiated by reference to accepted fundamentals, or by reasoned conclusions based on logical principles. In the absence of fundamental guidelines, the measurement of an equitable adjustment must rely upon the latter method. No preset formula is available to furnish a relatively simple answer to the problem of pricing a change. What constitutes an equitable adjustment remains a question to be decided on the facts of each case.

2-2. At this point, it might be noted that there is no objection to predetermination of the method to be used to calculate an equitable adjustment. The parties may agree to such preset formula at the time of negotiating the basic contract where there may be reason to believe that fundamental conceptual difficulties may later arise.

2-3. Approaches to Measuring Equitable Adjustment. Basically, there are two fundamental concepts, and several approaches, to measuring an equitable adjustment. They can be identified and characterized because they are a matter of record, having been the subject of appeals and litigation: (1) the Reasonable Value or "Objective" concept; (2) the Specific Cost or "Subjective" concept' (3) the Total Cost Approach; (4) the "Jury Verdict" Approach; and (5) the "Bruce Case" Rule.

2-4. The Reasonable Value Concept. The proponents of this approach point out that the appeals boards and courts have applied the standard of reasonable value or reasonable worth as the proper measure of compensation to many cases in which Changes clauses were at issue. The rule is that remuneration to the contractor should be equated with the reasonable value of goods or services obtained from the contractor. Restated in another way, the contractor is compensated on the basis of what the change should cost, rather than what it actually cost.

2-5. Admittedly, the ascertainment of value is difficult. It is far more difficult than the ascertainment of incurred costs. The term value is used in different contexts; it means different things to different people. Its determination involves conjecture, opinion and judgment. It varies with time, place and circumstance.

2-6. In the eyes of the law, value is not equated with cost; the terms have quite different meanings. An itemized repair bill, for instance, is only some evidence of the value of damages suffered in an automobile collision. So it is with Government contracts. Many cases serve to illustrate that value is not tied to cost. For instance, in S. N. Nielsen Company v. U.S., (141 Ct. Cl. 793, 1958) a reduction in the contract price was approved, though the contractor established that the change had increased his costs. Conversely, in Bruce Construction Corporation (Eng. BCA 1959) the contractor was entitled to the difference in value of more expensive sand block required by a change order, though the contractor's supplier did not charge for the increased cost of the block over that originally ordered under the contract. (But see the Bruce Case rule, infra, overturning this decision.)

2-7. The basic premise here is clear. It is that the determination of an equitable adjustment as an objective procedure which involves the determination of the reasonable value (or the reasonable costs of a prudent contractor similarly situated) of the work involved as opposed to the costs actually incurred by the contractor.

2-8. Proponents of the objective theory of equitable adjustment frequently cite the Nielsen Co. decision in support of their position. In that case, an erroneous bid of a subcontractor had misled the contractor into allocating only $22,000 to an item of work on its contract. By change order, the Government substituted a less expensive installation, decreasing the cost of the item of work to $19,000. However, the Government was able to prove that it would have cost the contractor some $60,000 to perform the item for work if it had not been changed. In a series of appeals, the Contracting Officer's contention that the Government was entitled to an equitable adjustment in the form of a price decrease of $41,000 was sustained. (See also, Keco Industries, Inc., v. U.S., 176 Ct. Cl. 983 (1966) and Pruitt, Inc., ASBCA 18344, 73-2 BCA Para. 10580.)

2-9. Such decisions are characterized as an unequivocal vote for the objective or reasonable value approach to a change. In a direct confrontation between the equities of affording the Government the savings which would normally be realized from such change and the contrasting need to spare the contractor a possible serious loss, the reasonable value approach was decisively applied.

2-10. These decisions, briefly summarized, stand for the principle that the determination of an equitable adjustment is the difference between what it would have reasonably cost to perform the work as originally required and what it reasonably cost to perform the work as changed. Therefore, the reasonable cost to the contractor to perform the services had they not been changed, must be computed in order to arrive at a proper equitable adjustment. In such case, the contractor's cost estimates to perform the work as originally specified are subject to scrutiny by the Government. If the original estimates are considered unreasonable, the equitable adjustment will give effect to the difference between a reasonable estimate of the original cost, rather than the contractor's actual original cost estimates.

2-11. We note that the determination of an adjustment by the reasonable value approach does not preclude the use of the contractor's cost estimates as a basis, at least for comparison purposes. The problem of properly computing an equitable adjustment is considerably simplified where the change and the pricing of the change are effected concurrently. There can be no question under this circumstance that the Government and the contractor have bargained for a price on an objective basis, and that the price is the result of the value of the change as opposed to the actual cost of the change. The contractor's estimates have been subjected to a comparison with similar purchases and with perhaps, the Government's independent estimates. The pricing of a change by this method completely acceptable and is not subject to revision even though later cost information reflects that actual costs of the change are substantially lower or higher than the value established by the price negotiation.

2-12. In line with the philosophy of fixed-price contracting, forward-pricing of equitable adjustments is the preferred policy. Such forward-pricing involves the best estimates based on known data. In many instances, however, the circumstances may be such as to preclude a possibility of forward pricing. Equitable adjustments are often determined ex post facto when costs relevant to the change have already been incurred. The known costs may be used in the determination of the reasonable value of the adjustment. If such is required.

2-13. It becomes quite apparent that actual costs, as incurred by the contractor, are generally considered to be a primary indicator of the value of the change. Even the proponents of the reasonable value approach to equitable adjustments concede that there is no better single indicator of value than actual costs. Decisions of the Boards and the Courts often refer to "actual cost of repairs" or "actual cost to the contractor." The line of reasoning in the decisions reflects, however, that even while recovery of costs per se is permitted, only those costs which are reasonable, necessary and unavoidable are allowed.

2-14. The Specifle Cost Concept. In direct contrast with the theory of reasonable value, the subjective theory of "specific cost" propounds that the proper measure of an equitable adjustment is the actual cost of the change to the particular contractor affected. This theory rejects the elusive standard of "reasonable value" and sets up the standard of actual cost of the change as being the most equitable method of adjustment.
2-15. A pause for reflection at this point will impress upon the student the apparently irreconcilable conflict between the basic approaches. We have seen that the ascertainment of the "value" of a change may be quite difficult, since the legal concept of value is based on theory. To determine value we often look to the contractor's cost estimates or his actual cost of work performed. For example, consider the pricing circumstances involved in a constructive change, or those involved in a constructive change, or those involved in the so-called "two-part" change order. The latter involves the direction of a change by the Contracting Officer followed by a subsequent determination of the price of the change. In many instances the work is completed prior to the price negotiation, and the contractor comes to the bargaining table armed with his actual costs. Would an acceptance of these costs, and an addition of a "reasonable and customary" profit constitute a cost-plus-percentage of cost procurement, a transaction prohibited by 10 U.S.C. 2306(a)?

2-16. Undoubtedly, some Contracting Officers have been reluctant to use actual costs incurred as a result of a change in the face of the cost-plus-percentage-of-cost prohibition. Would it be more prudent to depart completely from a subjective analysis of the contractor's costs and scrutinize him objectively, comparing him with a manufacturer whose management is, possibly, more skillful or whose labor is more experienced in the same or similar task? Is it equitable to expect that the contract be performed as efficiently as it might be under the optimum conditions which the objective theory suggest?

2-17. The proponents of the subjective theory dispose, first, of the argument concerning possible cost-plus-percentage-of-cost implications. They suggest that the prohibition is directed toward predetermined arrangements granting additional profit in the event additional costs are incurred. After-the-fact pricing, they point out, gives no such guaranteed profit. This argument is sustained by recent decisions of the Boards and the Courts. in National Electronic Laboratories v. U.S., (148 Ct. Cl. 308 F. Supp. 377, 1960) the court ruled that a redeterminable contract priced after the fact was not in violation of the cost-plus-percentage-of-cost prohibition. Hence, the Contracting Officer should use the best evidence available, including the latest costs incurred, when negotiating an equitable adjustment. And in a case involving a "Changed Conditions" clause, the Board clearly reiterated the distinction between an ex post facto determination of an equitable adjustment and a CPPC situation by stating:

> ...We think the differences between the allowance of any equitable adjustment and the cost-plus-a-percentage-of-cost system are substantial and obvious. Under the "Changed Conditions" article the contractor has no guarantee that historical costs will be allowed... Although profit may be expressed in terms of percentage the "Changed Conditions" article does not contain a guaranteed percentage and this too, is determined on the basis of the best evidence available. E.V. Lane Corp., ASBCA Nos. 9741. 9920 and 9933, 65-2 BCA 5076 (1965).

2-18. The proponents of the subjective approach to equitable adjustments further point out that many of the "Changes" clauses were developed to provide administrative remedies to situations which would otherwise be breach of contract cases before the courts. The approach to administrative settlement should then be patterned after the treatment, generally accorded by courts, to claims for damages resulting from breach of contract. Therefore, the incurred cost approach, so common in damage claims, should also be followed in equitable adjustment cases.

2-19. Summarizing what we have thus far learned of the basic approaches to equitable adjustment, it can be briefly stated that differences in theory are as follows: (1) the Reasonable Value Approach defines an equitable adjustment in terms of the objective determination of what it should cost a reasonable and prudent contractor in performing under optimum conditions; (2) the Specific Cost Approach, conversely, defines an equitable adjustment in terms of actual cost incurred by the particular contractor under the circumstances of his contract; and (3) under either theory, the contractor's cost--whether estimated, actual, or historical--may be used in the determination, the fundamental difference being in the probative value or evidentiary weight which each theory assigns to such costs.

2-20. The Total Cost Approach. Where actual or historical costs are submitted for the Government's consideration, the burden is upon the contractor to show that they were actually incurred. If he fails to prove this, but does show an entitlement to an equitable adjustment, a determination on quantum can nevertheless be made by either of two methods. The first is the "total cost" method.

2-21. The total cost of the change is the determination of the difference between the original contract price (unchanged) and the actual cost of performing the contract as changed. Simply, it is actual cost versus originally expected cost. This method is universally criticized as being the least preferable approach to an equitable adjustment on at least two grounds: (1) that the total costs include not only the costs properly attributable to

the change, but also those which were incurred through the fault of the contractor, and (2) that the cost of performing the unchanged contract is frequently based on unrealistically low bids. The bail-out aspects of this method, therefore, are quite apparent.

2-22. This method has been used when there is no better method available. The Court of Claims, for instance, has stated that the total cost approach has been used only as a last resort. In order to overcome the serious objections inherent in this approach, the Court has been careful to ascertain the contractor's experienced costs resulting from the change, and has reduced those costs by deducting costs attributable to the fault of the contractor. Thus, the first major criticism, supra, is eliminated. Next, the Court attempted to avoid the second major criticism by using an average estimate, derived from the estimates of the Government and the other bidders, in order to preclude the possibility of "getting well" on changes after a buy in. The leading case on the use of the total cost approach is Great Lakes Dredge and Dock Co. v. U.S., 119 Ct. Cl. 504 (1951), cert denied, 342 U.S. 953 (1952).

2-23. Conversely, the Court of Claims has expressed its distaste for the application of this approach in subsequent decisions. The total-cost basis was specifically rejected in F.H. McGraw & Co. v. U.S., 131 Ct. Cl. 501 (1955) and in River Construction Corp. v. U.S., 159 Ct. Cl. 254 (1962). More recently, while reiterating its distaste for the approach, the court conceded that the total cost basis may be used under appropriate circumstances and when no other method is available. J.D. Hedin Construction Inc., v. U.S., 171 Ct. Cl. 70 (1965)). The rationale of the Court may be summarized by the following quotations from this case.

> We are aware that we have on a number occasions expressed our dislike for this method (total cost) of computing breaches of contract damages, and we do not intend to condone its use as a universal rule. However, we have used this method under proper safeguards where there is no other alternative, since we recognized that the lack of certainty as to the amount of damages should not preclude recovery. Oliver-Finnie Co. v. United States, 150 Ct. Cl. 189 279 F. 2d 498 (1960): MacDougald Construction Co. v. United States, 122 Ct. Cl. 210 (1952): The Great Lakes Dredge and Dock Co. v. United States. 119 Ct. Cl. 504.96 F. Supp. 932 (1951). cert denied,. 342 U.S. 953 (1952). In all these cases the fact of Government responsibility for damages was clearly established; the question was how to compute reasonable damages where no other method was available. River Construction Corp. v. United States supra. at 271. We think this is such a case...The only possible method by which these damages can be computed is to resort to the total cost method. Under such circumstances, as stated earlier, we think the Government should not be absolved of liability for damages which it has cased, because the precise amount of

added costs cannot be determined. (Though the reference in this case is to damages, the same rationalization is used by the Court of Claims in computing equitable adjustments.)

2-24. The various Boards of Contract Appeals have exhibited less favor in the use of the total cost method. The ASBCA, for instance, has rejected this approach in substantially denying appeals in Holly Corporation, ASBCA No. 3626, 60-2 BCA 2685 (1960), H.R. Henderson and Co., et al., ASBCA No. 5146, 60-1 BCA 2662 (1960), and Air-A-Plane Corporation, ASBCA No. 3842, 60-1 BCA 2547 (1960). The Board's views regarding equitable adjustments can be summarized in the following excerpts from the latter case:

> ...We do note that appellant's insistence on the total cost approach (without specifics as to the various changes, and without specifics as to their effect on such matters as direct labor, direct material, engineering, overhead, etc.) in and of itself presents what we believe to be an insurmountable obstacle to the allowance of the claimed equitable adjustment.
>
> We have held that the equitable adjustment in price under the changes article should be based on a comparison of the contractor's actual performance with the performance required under the original specifications, if the contractor acted reasonably in its choice of alternative methods of performance. See Appeal of G.M. Ca Manufacturing. Inc. ASBCA No. 1883. See also Appeal of Bostwick-Batterson Company. ASBCA No. 4636. In so holding we have recognized that there are many factors to be considered in determining an equitable adjustment in price for a change order but that by far the most important factor is cost...
>
> Citing the Appeal of S.N. Nielsen Company, ASBCA No. 1990. sustained by the Court of Claims in 141 Ct.Cl. 793, the Board has held that a proper adjustment is the difference between what it would have reasonably cost to perform the work as originally required and what it reasonably cost to perform the work as changed, and that in order to make a proper equitable adjustment the Board must compute what would have reasonably been the cost to the contractor to perform the contract had it not been changed. See Appeal of Modern Foods, Inc. ASBCA No. 2090.
>
> The Board has held that before a conclusion with respect to the proper amount of any equitable adjustment which a contractor may be entitled can be arrived at either by a Contracting Officer or by the Board, appellant must show some sound basis for a determination of the amount and that such a determination may not be made in a vacuum or based on speculation. See Appeal of Afodern Foods, Inc.,

ASBCA No. 2090 and Allegheny Sportswear Col, ASBCA nO. 4163.

Thus, to arrive at an equitable adjustment the Board needs two figures. First, the actual cost. Second, the cost, but for the changes.

2-25. In summary, it may be said that the various appeal boards have generally limited the use of the total-cost method to extreme cases when: (1) the contractor is known to be competent, (2) the Government has not developed a reasonable alternative estimate, (3) there is no suggestion that the original price is not reasonable and realistic, (4) the increased costs resulted solely from the changes, (5) costs cannot be allocated to specific changes, and (6) there is no other way to determine an equitable adjustment. (For recent cases illustrating conditions for use of the "Total Cost" approach, see: Continental Drilling Co., ENGBCA 3455, 77-1 BCA, paragraph 12280, 1976; Perini Corp., ENGBCA 3745, 78-1 BCA, paragraph 13191 (1978); Ingalls Shipbuilding Div., Litton Systems, Inc., ASBCA 17579, 78-1 BCA, Paragraph 13216 (1978)).

2-26. The "Jury Verdict" Approach. Where costs cannot be segregated and identified both the Government and the contractor may have to approach an equitable adjustment on the basis of estimates alone. In these cases where meaningful comparisons cannot be made from the available cost data, the Court and the Boards have permitted the use of expert opinion to estimate the cost of a change. From all of the evidence, including the opinions of qualified experts (e.g., estimators), the Court or Board then can determine what should be paid in the same manner as would a jury. This method, quite naturally, has become known as the "jury verdict" approach.

2-27. First advanced by the Court of Claims in Western Contracting Corp. v. U.S., 144 Ct. Cl. 318 (1958), the method was later adopted in similar situations by the Boards in Lake Union Drydock Co., ASBCA No. 3073, 59-1 BCA 2229 (1959) and Henly Construction Co., IBCA No. 249, 61-2 BCA 3240 (1961).

2-28. In Western Contracting in Court considered the opinions of qualified estimators regarding the reasonableness of the claimed costs, since they could not be substantiated in detail by the contractor's records, and determined the equitable adjustment on the basis of a "jury verdict". In Lake Union Drydock, the BCA had occasion to consider an adjustment to the co ractor due to a delay be the Government in furnishing material for the construction of mine sweepers. The following excerpts from the decision reflect the circumstances under which a "jury verdict" approach may be employed.

> 8..The amount of the claim was derived from estimates made by Appellant's experienced shipbuilders. In presenting

> the claim to the Board. Appellant's principal marine architect and engineer (highly qualified) testified in great detail as to the basis of the estimates and verified exhibits submitted in support thereof. Generally speaking we find that Appellant's estimators are well qualified to make the estimates upon which this claim is founded and that those estimates were established as being basically sound.
> 9...On the other hand, the Government did not make a separate estimate of the proper price adjustment due to the delay attributable to it. Instead, in presenting the defense in this appeal, counsel for the Government probed into every element of Applelant's estimate... Thus, as presented, we have before us over two thousand pages of transcript of the hearing and over a thousand sheets of exhibits upon which to base a decision which. In most part, is one of the nature of a jury verdict. To discuss the many minor details in controversy seems unnecessary. May it suffice to say here however, that the measure of the amount of the price adjustment to which appellant is entitled is not an exact science calling for a hard and fast rule, but is a determination based upon the facts and circumstances of this case. See Needles v. United States. 101 Ct. Cl. 535, 618; Fern E. Chalendar V. United States, 127 Ct. Cl. 557, 566; Western Contracting Corporation v. United States. No. 344-55 Ct. Cl decided December 3. 1958.

2-29. The same approach was used by a different Board in rendering a decision in Henly Construction Co., supra. It should be noted that despite the name of this method, a jury as such is not actually used. The expert testimony of both sides is weighed by the judges or by the Board, and the evidence is weighed as if by a trier of fact, (i.e., the jury).

2-30. However, the ASBCA subsequently appeared to place a number of restrictions on the use of this approach. In Air-A-Plane Corp., supra, it stated that this theory is applicable only in cases "where each side presents convincing but conflicting evidence as to what the amount of equitable adjustment should be; where, upon consideration of the evidence, neither side is entirely correct, and it is apparent that some allowance by the Board is proper, and where evidence is sufficient to permit the Board to make some reasonable decision as to a proper

allowance..." And in Planetronics, Inc. ASBCA No. 7202, 1962 BCA 3356, an additional requirement for "convincing proof of the nature and kinds of increased costs incurred" was added.

2-31. The basic difference between the "total cost" approach and the "jury verdict" approach is that in the latter, costs attributed to the change alone are used while in the former, the total contract costs are used. A severe criticism of the "jury verdict" method remains, in that despite the narrower area of consideration (i.e., the change alone) the computation still involves considerable speculation.

2-32. More recent cases, however, attest that the Court of Claims and the Boards continued to use this approach. For instance, in J.G. Watts Construction Co. v. U.S., 174 Ct. Cl. 1, (1966), the Court reiterated the use of the jury verdict basis where precise measurement of costs is not possible. The Boards, also, pursue the rationale of making their own estimate in a "jury verdict" where "...Even though presented with widely divergent positions by the parties before us, we cannot escape the necessity of bringing an end to the matter and determining a figure as the amount of an equitable adjustment." (For recent cases illustrating the wide discretion exercise by Boards of Contract Appeals in applying "Jury Verdict' techniques, see; Sovereign Construction Co., ASBCA 17792, 75-1 BCA, paragraph 11251 (1975; Greenwood Construction Co., AGBCA 75-127, 78-1 BCA, paragraph 12893 (1977); J.W. Bateson Co., VACAB 1148, 79-1 BCA, paragraph 13573 (1978). For a very liberal Court of Claims approach, see S.W. Electronics & Mfg. Corp. v. U.S., Ct. Cl (July 1981).

2-33. The "Bruce Case" Rule. As we have seen, the fundamental conceptual difference in the measurement of an equitable adjustment in between the objective (reasonable value) and subjective (actual cost) standards. We have also noted that an important element of a determination under either concept or, as a matter of fact, under the "total cost" and "jury verdict" approaches-is "cost."

2-34. An important recent development in defining this significant element of "cost" and, in effect, narrowing the area of controversy among the fundamentalists is the series of decisions involving the Bruce Construction Corporation.

2-35. The rule emanating from these cases is that the proper measure of value of an equitable adjustment is the "contractor's costs, reasonably incurred". Emphasis is supplied here to impress the reader with the brevity and simplicity of the rule, despite the magnitude of its pronouncement.

2-36. A second look will reveal that the rule is a compromise between the objective and subject concepts. The rule gives weight to the objective standard in that the costs must be reasonably incurred, but does not otherwise disturb the

subjective fundamental of the contractor's costs. This appears to be the prevailing rule, and the quid pro quo whereby fundamental differences may be resolved in the interests of a workable standard for "equitable" adjustment.

2-37. The Bruce case involved a fixed-price construction contract for a number of buildings at Homestead Air Force Base, Florida. A fine-textured building block was required by the original specifications. After the contractor had ordered the building block, the requirement was changed to sand block. The sand block was more brittle than the concrete masonry block generally produced in that area, requiring a higher degree of care in its handling, and entailing a higher production cost. However, the contractor's supplier furnished the sand block at the same price as the originally required concrete block.

2-38. The issue arose when the contractor claimed, $42,415.98 as the difference between the value of the sand block furnished and the value of the block originally specified, on the grounds that the fair market value of the sand block was greater than the purchase price and that the Government should not benefit from the contractor's bargain.

2-39. The Corps of Engineers accepted the contractor's contention that fair market value should be the measure of an equitable adjustment, and allowed the difference between the current fair market value of the two types of block. Upon appeal, since the Engineering Board of Contract Appeals had denied the larger part of the contractor's overall claim, the ASBCA accepted the fair market value measure, but denied the claim on the basis of failure of proof, i.e., that the contractor had failed to prove that the price paid for the original concrete block was not also the fair market value of the substituted sand block at the time of the transaction. The Board held that the fair market value at the time of purchase, not at some subsequent time, is to be used in considering the validity of the equitable adjustment, and that the fair market value at the time of purchase was not different from that of the substituted block.

2-40. Upon further appeal, the Court of Claims resolved the issue in Bruce Construction Corp. v. U.S., 324 F. 2nd 516 Ct. Cl. (1963). The Court held that fair market value was not the proper measure of damages, that the proper measure is to be achieved by the application of objectivity (the reasonable cost test) to the contractor's actual or historical costs, and that the contractor's historical costs are presumptively reasonable and the burden of proof rests with the party contending otherwise.

2-41. Consider, for a moment, the implications of this decision in light of what we have thus far learned of equitable adjustments. The language of the Court may assist us.

> ...But fair market value is not the measure of damages in this case.

> This is not to say that in all cases, historical cost is to be the gauge. The more proper measure would seem to be a "reasonable cost". The concept of "reasonable cost" is not new. Indeed it has been defined in the following manner:
>
> A cost is reasonable if in its nature or amount, it does not exceed that which would be incurred by an ordinary prudent person in the conduct of competitive business.

Use of the "reasonable cost" measure does not constitute "an objective and universal procedure, involving the determination of the reasonable value (or reasonable cost of any contractor similarly situated) of the work involved". But determination of reasonable cost required is an objective test. The particular situation in which a contractor found himself at the time the cost was incurred, Appeal of Wyman-Gordon Co., ASBCA 5100 (1959) and the exercise of the contractor's business judgment, Walsh Construction Co. ASBCA 4014 (1957), are but two of the elements that may be examined before ascertaining whether or not a cost was "reasonable."

> (3) But the standard of reasonable cost "must be viewed in the light of a particular contractor's costs*** (Emphasis added), and not the universal, objective determination of what the cost would have been to other contractor at large."

2-42. It is clearly apparent that the Court rejected the purely objective "reasonable value" concept, and substituted the new test--a "modified subjective' one--of the application of the objective standard of "reasonableness" to the actual or historical costs under the contractor's particular circumstances (subjective).

2-43. The above statements in themselves would appear to be an accurate reflection of the practicable aspects of equitable adjustment. Viewed in the light of the negotiations that normally accompany the determination of the quantum of a change, and the concessions normally made in the course of the discussions, the application of the standard of reasonableness is not at all strange. The Court's opinion at this point could be considered to be a not-too-distant departure from the practical (as viewed by the subjective and objective theorists) and an affirmation of the practicable (as viewed in light of the usual circumstances of an equitable adjustment).

2-44. The Court further held that the contractor's "historical" costs are presumed reasonable and that the burden of proof rests with the party contending otherwise:

> To say that "reasonable cost" rather than "historical cost" should be the measure does not depart from the test applied in the past, for the two terms are often synonymous. And where there is an alleged disparity between "historical" and "reasonable" costs, the historical costs are presumed reasonable.

Since the presumption is that a contractor's claimed cost is reasonable, the Government must carry the heavy burden of showing that the claimed cost was of such a nature that it should not have been expended, or that the contractor's costs were more than were justified in the particular circumstance.

2-45. Note that, in this case, the burden of proof was upon Bruce, since its allegation was that the actual cost of the sand block was not reasonable. The court disposed of the Bruce Case in the following language:

> (4) Plaintiffs here have not been able to overcome the presumption that their actual costs were reasonable, hence they may not recover...evidence of the fair market value of an item some eighteen months after a transaction involving the item does not rebut the presumption that the cost of the item was reasonable at the time of the transaction.

2-46. Following the logic of the Bruce Case rule, it is clear that, in the usual controversy, the burden of proof will be on the Government to prove that the contractor's costs were not objectively reasonable. Actual or historical costs are now of prime importance; they are no longer just some evidence of reasonable cost. They are reasonable until the presumption is rebutted. (For an example of the difficulty in providing that the contractor's actual costs are unreasonable, see: Bromley Constructing Co., ASBCA 20271, 77-2 BCA, paragraph 12715 (1977)).

2-47. This, is the Bruce Case rule. It has been widely adopted by the Boards as the guideline for a proper measure of an equitable adjustment. This "reasonable cost" test has been used consistently since its promulgation by the Court of Claims in 1963. For example, see J. G. Watts Construction Co., ASBCA 9454, 1964 BCA 4325, and Hayes International Corp., ASBCA 9750, 65-1 BCA 4767 (1965). For a case denying the reasonableness of a contractor's actual costs, see Blauner Construction Co., ASBCA 9436, 1964 BCA 4333.

3. TYPES OF INCLUDABLE COSTS

3-1. Now that it is apparently settled that the kind of cost allowable in an equitable adjustment is "actual cost reasonably incurred", one other major issue remains. It concerns the type of cost which will be allowable within definition.

3-2. The rule in Hadley v. Baxendale, we have noted, restricts the recovery to damages which are direct, not consequential. This same distinction has been applied to equitable adjustments. It is settled that where a breach does not arise "naturally", or was not "in the contemplation of both parties at the time they made the contract", the damages (or reasonable costs thereof) are considered consequential and are not recoverable. But when is a cost direct, and when is it consequential?

3-3. Changed vs. Unchanged Work. Two important cases merit our consideration at this point. In Chouteau v. U.S., 95 U.S. 61 (1877), the Supreme Court said, in deciding an early case:

> For the reasonable cost and expenses of the changes made in the construction, payment was to be made; but for any increase in the cost of the work not changed, no provision was made.

3-4. The Court quoted and agreed with this statement in a later "landmark" case involving standby costs on construction contracts. This was the case of U.S. v. Rice, 317 U.S. 61 (1942), where the contractor alleged standby and other additional costs resulting from changes in specifications over a long period of time. In denying the claim, the Supreme Court stated:

> It seems wholly reasonable that "an increase or decrease in the amount due" should be met with an alteration in price, and "an increase or decrease... in the time required should be met with alteration of the time allowed, for "increase or decrease of cost" plainly applies to the changes in cost due to structural change required by the altered specifications and not to consequential damages which might flow from delay taken care of in the "difference in time" provisions.

3-5. The language of these two decisions could be interpreted differently; as a result, there was a great deal of confusion as to the type of costs that could be included in an equitable adjustment.

3-6. The impact of the Rice Doctrine was ameliorated in 1957, so far as supply contracts were concerned, by the introduction of

appropriate language in the Standard Form 32 "Changes" clause. The addition of the words "whether changed or not changed" would appear to have taken supply contracts out of the operative effect of the doctrine. Subsequent interpretations by the Boards permitted recovery of the cost of delays after a change order was issued but not those incurred before the change order, on the grounds that the new Changes clause still provided for an adjustment in costs caused by the change and that costs incurred prior to a change could not have been caused by the change.

3-7. There are exceptions to this rule. For instance, costs incurred before the change order will not be excluded if it can be proved that they were caused by the change. This distinction is principally involved in the area of defective specifications, where costs incur before discovery of the defects are regularly included in the equitable adjustment. See Spencer Explosives, Inc., ASBCA 4800, 60-2 BCA (1960); and R.C. Hedreen Co., ASBCA 20599, 77-1 BCA paragraph 12328 (1977).

3-8. In supply and research and development contracts, in summary, the application of the Rice Doctrine generally limited recovery to subsequent delays caused by the change. Recovery for delays prior to the change, except for cases involving defective specifications had to be affected under Stop Work Orders or Suspension of Work clauses rather than the Changes clause.

3-9. The greatest impact of the Rice Doctrine was in the area of construction contracts. A 1961 revision of Standard Form 23A, the Changes clause for construction contracts, contained substantially the same wording as SF32. However, the similarity did not obviate the operative effect of the doctrine. The omission of the words "any part of work...whether changed or not changed by any such order" was fatal. The Rice Doctrine continued to be fully applicable; there could be no adjustment in costs for the effect on other unchanged work and the only permissible adjustment was an extension in time.

3-10. This situation was drastically changed by revising the Changes clause to eliminate some of the problems which for years had plagued the administration of construction contracts. The revised clause 9e.g. FAR 52.243-4, Changes) makes it clear that the change may relate to any aspect of the work to be performed under the contract. It embraces changes not only to drawings, designs and specifications, but also changes in the method and manner of performance, the provision of sites and services and those requiring acceleration in performance Significantly, paragraph (b) of the new clause recognizes "constructive changes" by providing that any other written or oral orders from the Contracting Officer including "direction, instruction, interpretation or determination", which cause a change within the general scope of the work shall be treated as changes under the clause.

3-11. In its provision for equitable adjustment the revised clause now resembles the supply and research and development Changes clauses in providing that "...If any change under this clause causes an increase or decrease in the Contractor's cost of or the time required for the performance of any part of the work under this contract whether or not changed by any such order, the Contracting Officer shall make an equitable adjustment..." (Emphasis supplied.) This wording following the construction of the wording in supply and R & D contracts, will have the effect of eliminating the application of the Rice Doctrine to construction contracts. It appears clear that the contractor may now receive consideration not only for the costs of the changed work but also for any increased costs in unchanged work incurred as a result of the change.

3-12. The clause also expressly provides for equitable adjustment in the case of defective specifications, removing any question as to the proper inclusion of prior costs which had been regularly allowed as in Spencer Explosives, Inc., supra.

3-13. Significantly, the clause also provides for possible recovery of costs incurred prior to a change order, other than those resulting from defective specifications. Such recovery of other costs is limited in that except for claims based on defective specifications no claim for change shall be allowed for any costs incurred more than 20 days before the Contractor gives written notice.

3-14. "Impact" Cost; The "Ripple Effect". One of the most difficult types of claim to resolve is one based upon "impact" costs. The theory here is that a major change or a number of such changes have a "ripple effect" upon the remainder of the contract work. Where there is a compression of time or a significant addition of work without concomitant extension of time the impact may arise for example, from a resultant loss of efficiency from abnormally long hours of premium time. This inefficiency may affect management and supervision as well as direct labor. Further, when a change compresses the work required on a part of a project such compression may affect the scheduling of the work on other parts of the project. A pyramidal effect is encountered where the disturbance caused by a patent change will cause a "ripple effect" of smaller disturbances, perhaps latent, throughout the contract work. The allegation here is that such changes have a direct effect on costs. Scheduling is disrupted, learning is interrupted, and premium prices must often be paid for labor and materials.

3-15. The issue of whether such "impact" costs are recoverable as direct, rather than consequential, costs has been squarely presented. The contractor has been permitted to recover for loss of efficiency because of an acceleration requirement. The Court of Claims took judicial notice of the fact that a 12 hour work day and a six day workweek tends to impair the efficiency of a contractor's labor. The ASBCA has also determined that such

factors as an interruption to the work sequence, lack of a steady flow of work, and the unavoidable use of unskilled labor may seriously affect a contractor's efficiency. In fact, it appears that the ASBCA uses a figure of 30% as a general experience factor for loss of efficiency during winter weather, with the factor being reduced to 20% where a substantial part of the work is performed indoors. (For an illustrative case involving a method of reaching an equitable adjustment on a claim of loss of efficiency, see T.C. Bateson Construction Co. v. U.S., 177 Ct. Cl. 1094 (1966 However, the cases reiterating claims of loss efficiency must be supported by proof. Appeal of Hicks Corp., ASBCA 20760, 66-1 BCA 5469 (1966). The Boards appear to be more lenient on the requirement of proof than the courts. Contrast Joseph Pickard's Sons Co. v. U.S., 209 Ct. Cl. 643 (1976) with California Shipbuilding & Dry Dock Co., ASBCA 21394, 78-1 BCA. para 13168 (1978). The many examples of such "impact" costs establish that the trend of the decisions is to afford recognition to the "ripple effect" in treating such costs as being a direct and natural result of certain changes and therefore, recoverable.

3-16. However, the result has not been the same where the contention was that the number of changes alone should be the criterion for an allowance of "impact" costs. The rule here seems to be that rather than the number of changes, the important consideration is the effect of these changes as a whole upon the contract.

3-17. Indirect Expenses; Overhead. Thus far we have been considering "direct" costs in the legal sense. We now encounter the expression "direct costs" in accounting terms. Such direct costs (e.g., direct labor, direct material, direct engineering) resulting from changes would normally be no problem. If it is established that they were reasonably incurred (Bruce Case Rule) as a direct result of change (Hadley v. Baxendale), the costs are recoverable in an equitable adjustment. However, the problem arises in the recovery of "indirect costs", again in accounting terms. These costs are generally referred to as "overhead" or "burden" and include; for example, such items as employee benefits, taxes, insurance, rent, etc. Overhead can further be broken down into costs that are fixed, variable, or semi-variable. Fully variable costs are those which increase (or decrease) in direct proportion to an increase (or decrease) in production. Fixed costs (e.g., rent or taxes) remain relatively constant regardless of fluctuations in production. A change may well increase direct labor costs without affecting overhead to any significant degree since the fixed elements in overhead may not be affected at all.

3-18. What is the proper technique for pricing an equitable adjustment in this circumstance? Quite generally, contracting officers accept the contractor's standard accounting practice of applying overhead as a percentage of direct labor; as was done in the basic contract though the change may have significantly

altered the original contract circumstances. One should be aware that the application of such percentage overhead rates could result in an unintended profit (or loss) to the contractor.

3-19. There is apparently no agreement in this area of equitable adjustment as reflected in BCA decisions. In J.G. Watts Construction Co., ASBCA 9454, 1964 BCA 4171, recovery on the basis of the contractor's normal overhead rate was permitted, despite the Government's contention that the adjustment should include only those costs in overhead that were directly increased by the change. Converely, in B. J. Lucarelli Co., ASBCA 8768, 65-1 BCA 4655 (1965), the board rejected the contractor's claim of "normal overhead rate" for home office expense where it was not proven that the added work actually increased such home office expense.

3-20. Since the cases furnish no guideline, a practical approach might be in order. Where minor changes are involved, a continual renegotiation of the overhead rate would be unduly burdensome. In this circumstance, the parties might prefer to consider possible fluctuations in overhead as normal business contingencies and allow any gain or loss to fall where it may. However, where a significant change in overhead is indicated by the large number of direct labor hours involved in the equitable adjustment, the parties should probably negotiate a new rate to preclude the possibility of an unconscionable profit or loss.

4. PROFITS

4-1. The Boards have held that on changed work the contractor is entitled to reasonable additional costs actually incurred, plus overhead applicable thereto, and a fair profit. However before a profit can be allowed as part of an equitable adjustment, it must be clear the contract permit such an allowance, either expressly or by implication. For example, where the contract limited an equitable adjusement to the payment of costs, the Board denied recovery of profits. The "Suspension of Work" clause (FAR 52.212-12) is an example of a clause specifically excluding profit from any adjustment resulting from a suspension, delay or interruption in work.

4-2. Amount. Since it appears settled that profit is allowable, only the question of quantum remains. The situation here is similar to that encountered in the indirect cost area, supra. Should the existing percentage profit factor be applied, or does the nature of the change require a separate negotiation of profit?

4-3. In computing the profit applicable to an equitable adjustment we find again that there is no absolute formula. In the case of minor changes the pattern seems to be the application of the existing percentage profit factor, i.e, that profit percentage contained in the basic contract. In the case of major changes, however, the "Weighted Guidelines" approach, (e.g. FAR

Subpart 15.9, Profit) would require the determination of profit specifically applicable to the change.

4-4. The better and prevailing view appears to be that profit is an allowable factor but that the amount of profit will be determined by the facts in each case. Profit, like any other factor in an equitable adjustment, is subject to negotiation and agreement between the parties. The amount of profit will be dependent upon the character of the work involved; each case must be examined in light of its peculiar facts. The determination of the quantum of profit therefore, involves a question of fact.

4-5. The profit included in an equitable adjustment need not necessarily be related to that established in the basic contract or in any previous equitable adjustments on that contract. It also follows that the test is not whether the change is additive or deductive, but that the character of the change is the determinative factor.

4-6. Normally a contractor is not entitled to a higher rate of profit for increased work than he would have received had the work not been increased. However, where the circumstances so merit, the board has not been averse to awarding a higher profit or fee than existent in the original contract. For instance, in American Pipe Steel Corp., ASBCA 7899, 1964 BCA 4058 the board sustained an increase in fee from 7 percent to 10 percent on the basis that the change required an increase in the level of effort. To reiterate its position that a profit allowance on changed work need not be limited by the profit factor in the original contract, the board allowed 10 percent on changed work when the original contract bore a profit factor of 6.92 percent. (Illustrating its flexibility in matters of profit the Board in Carvel Walker, ENGBCA 3744, 78-1 BCA, paragraph 13005 (1978), allowed a 12% profit factor while commenting that 10% had been customarily used in construction contracts. In another case the Board merely reaffirmed the profit factors used by the Contracting Officer; Space Dynamic Corp., ASBCA 19118, 78-1 BCA, para 12885 (1978)).

4-7. Conversely, where work is decreased by a change a profit deduction is proper. The determination of profit on equitable adjustments resulting from changes decreasing work is made in the same manner as in added work. The same principles used in pricing additive changes are applicable to deductive changes.

4-8. One other important point should be made in this discussion of profit. When the contractor cannot establish entitlement to an equitable adjustment under the terms of the contract, his only alternative for recovery is in a breach of contract action. Traditionally, the courts will allow recovery of anticipatory profit in successful suits for damages for breach of contract. The rationale is that the function of damages is to put the contractor in the position he would have enjoyed but for the breach--to make him "whole" as it were. In the eyes of the law

damages are recoverable for the injury or loss suffered. Making the injured party pecuniarily "whole" includes awarding profit as an element of damages in order to preserve "the benefit of the bargain."

4-9. The fundamental rule of damages is of prime importance to both the Government and the contractor when the choice is between equitable adjustment under the contract or a breach of contract claim. Despite entitlement the appropriate clause of the contract may by its wording preclude the recovery of profit as an element of the equitable adjustment. On the other hand where the contractor may also have grounds for a breach of contract claim a successful appeal to the courts could enhance his recovery to the extent of anticipatory profits. The possibility of a larger recovery must always be considered in light of the additional time and costs involved. It is to the advantage of both the Government and the contractor to seek an equitable adjustment within the terms of the contract or to resolve their differences by accord and satisfaction whenever possible. The contracting officer should always bear in mind this vital distinction between breach of contract and equitable adjustment.

NOTE: The presumption of reasonableness of Contractor's costs opined in the Bruce Case Rule (2-33, etc seg.) was modified by the DOD FY86 Appropriations Bill which clarified and restricted the scope of the rule. Thereafter, the presumption of reasonableness applied to direct costs, e.g. Direct Labor, Direct Materials, Direct Engineering, etc; indirect costs (burdens) no longer benefited from the presumption. Recent case law reflects these changes.

PART 43

CONTRACT MODIFICATIONS

43.000 Scope of part.

This part prescribes policies and procedures for preparing and processing contract modifications for all types of contracts including construction and architect-engineer contracts. It does not apply to—

(a) Orders for supplies or services not otherwise changing the terms of contracts or agreements (e.g., delivery orders under indefinite-delivery contracts); or

(b) Modifications for extraordinary contractual relief (see Part 50).

SUBPART 43.1—GENERAL

43.101 Definitions.

"Administrative change" means a unilateral (see 43.103(b)) contract change, in writing, that does not affect the substantive rights of the parties (e.g., a change in the paying office or the appropriation data).

"Change order" means a written order, signed by the contracting officer, directing the contractor to make a change that the Changes clause authorizes the contracting officer to order without the contractor's consent.

"Contract modification" means any written change in the terms of a contract (see 43.103).

"Effective date" has various meanings based on the circumstances in which it is used:

(a) For a solicitation amendment, change order, or administrative change, the effective date shall be the issue date of the amendment, change order, or administrative change.

(b) For a supplemental agreement, the effective date shall be the date agreed upon by the contracting parties.

(c) For a modification issued as a confirming notice of termination for the convenience of the Government, the effective date of the confirming notice shall be the same as the effective date of the initial notice.

(d) For a modification converting a termination for default to a termination for the convenience of the Government, the effective date shall be the same as the effective date of the termination for default.

(e) For a modification confirming the termination contracting officer's previous letter determination of the amount due in settlement of a contract termination for convenience, the effective date shall be the same as the effective date of the previous letter determination.

"Supplemental agreement" means a contract modification that is accomplished by the mutual action of the parties.

43.102 Policy.

(a) Only contracting officers acting within the scope of their authority are empowered to execute contract modifications on behalf of the Government. Other Government personnel shall not—

(1) Execute contract modifications;

(2) Act in such a manner as to cause the contractor to believe that they have authority to bind the Government; or

(3) Direct or encourage the contractor to perform work that should be the subject of a contract modification.

(b) Contract modifications, including changes that could be issued unilaterally, shall be priced before their execution if this can be done without adversely affecting the interest of the Government. If a significant cost increase could result from a contract modification and time does not permit negotiation of a price, at least a maximum price shall be negotiated unless impractical.

43.103 Types of contract modifications.

Contract modifications are of the following types:

(a) *Bilateral.* A bilateral modification (supplemental agreement) is a contract modification that is signed by the contractor and the contracting officer. Bilateral modifications are used to— .

(1) Make negotiated equitable adjustments resulting from the issuance of a change order;

(2) Definitize letter contracts; and

(3) Reflect other agreements of the parties modifying the terms of contracts.

(b) *Unilateral.* A unilateral modification is a contract modification that is signed only by the contracting officer. Unilateral modifications are used, for example, to—

(1) Make administrative changes;

(2) Issue change orders;

(3) Make changes authorized by clauses other than a changes clause (e.g., Property clause, Options clause, Suspension of Work clause, etc.); and

(4) Issue termination notices.

43.104 Notification of contract changes.

(a) When a contractor considers that the Government has effected or may effect a change in the contract that has not been identified as such in writing and signed by the contracting officer, it is necessary that the contractor notify the Government in writing as

soon as possible. This will permit the Government to evaluate the alleged change and (1) confirm that it is a change, direct the mode of further performance, and plan for its funding; (2) countermand the alleged change; or (3) notify the contractor that no change is considered to have occurred.

(b) The clause at 52.243-7, Notification of Changes, which is prescribed in 43.106, (1) incorporates the policy expressed in paragraph (a) above; (2) requires the contractor to notify the Government promptly of any Government conduct that the contractor considers a change to the contract, and (3) specifies the responsibilities of the contractor and the Government with respect to such notifications.

43.105 Availability of funds.

(a) The contracting officer shall not execute a contract modification that causes or will cause an increase in funds without having first obtained a certification of fund availability, except for modifications to contracts that—

(1) Are conditioned on availability of funds (see 32.703-2); or

(2) Contain a limitation of cost or funds clause (see 32.704).

(b) The certification required by paragraph (a) above shall be based on the negotiated price, except that modifications executed before agreement on price may be based on the best available estimate of cost.

43.106 Contract clause.

The contracting officer may insert a clause substantially the same as the clause at 52.243-7, Notification of Changes, in solicitations and contracts. The clause is available for use primarily in negotiated research and development or supply contracts for the acquisition of major weapon systems or principal subsystems. If the contract amount is expected to be less than $1,000,000, the clause shall not be used, unless the contracting officer anticipates that situations will arise that may result in a contractor alleging that the Government has effected changes other than those identified as such in writing and signed by the contracting officer.

SUBPART 43.2—CHANGE ORDERS

43.201 General.

(a) Generally, Government contracts contain a changes clause that permits the contracting officer to make unilateral changes, in designated areas, within the general scope of the contract. These are accomplished by issuing written change orders on Standard Form 30, Amendment of Solicitation/Modification of Contract (SF 30), unless otherwise provided (see 43.301).

(b) The contractor must continue performance of the contract as changed, except that in cost-reimbursement or incrementally funded contracts the contractor is not obligated to continue performance or incur costs beyond the limits established in the Limitation of Cost or Limitation of Funds clause (see 32.705-2).

(c) The contracting officer may issue a change order by telegraphic message under unusual or urgent circumstances; *provided*, that—

(1) Copies of the message are furnished promptly to the same addressees that received the basic contract;

(2) Immediate action is taken to confirm the change by issuance of a SF 30;

(3) The message contains substantially the information required by the SF 30 (except that the estimated change in price shall not be indicated), including in the body of the message the statement, "Signed by (Name), Contracting Officer"; and

(4) The contracting officer manually signs the original copy of the message.

43.202 Authority to issue change orders.

Change orders shall be issued by the contracting officer except when authority is delegated to an administrative contracting officer (see 42.202(c)).

43.203 Change order accounting procedures.

(a) Contractors accounting systems are seldom designed to segregate the costs of performing changed work. Therefore, before prospective contractors submit offers, the contracting officer should advise them of the possible need to revise their accounting procedures to comply with the cost segregation requirements of the Change Order Accounting clause at 52.243-6.

(b) The following categories of direct costs normally are segregable and accountable under the terms of the Change Order Accounting clause:

(1) Nonrecurring costs (e.g., engineering costs and costs of obsolete or reperformed work).

(2) Costs of added distinct work caused by the change order (e.g., new subcontract work, new prototypes, or new retrofit or backfit kits).

(3) Costs of recurring work (e.g., labor and material costs).

43.204 Administration.

(a) *Change order documentation.* When change orders are not forward priced, they require two documents: the change order and a supplemental agreement reflecting the resulting equitable adjustment in contract terms. If an equitable adjustment in the contract price or delivery terms or both can be agreed upon in advance, only a supplemental agreement need be issued, but administrative changes and changes issued pursuant to a clause giving the Government a unilateral right to make a change (e.g., an option clause) initially require only one document.

(b) *Definitization.* (1) Contracting officers shall negotiate equitable adjustments resulting from change orders in the shortest practicable time.

(2) Administrative contracting officers negotiating equitable adjustments by delegation under 42.302(b)(1), shall obtain the contracting officer's

concurrence before adjusting the contract delivery schedule.

(3) Contracting offices and contract administration offices, as appropriate, shall establish suspense systems adequate to ensure accurate identification and prompt definitization of unpriced change orders.

(4) The contracting officer shall ensure that a cost analysis is made, if appropriate, under 15.805 and shall consider the contractor's segregable costs of the change, if available. If additional funds are required as a result of the change, the contracting officer shall secure the funds before making any adjustment to the contract.

(c) *Complete and final equitable adjustments.* To avoid subsequent controversies that may result from a supplemental agreement containing an equitable adjustment as the result of a change order, the contracting officer should—

(1) Ensure that all elements of the equitable adjustment have been presented and resolved; and

(2) Include, in the supplemental agreement, a release similar to the following:

CONTRACTOR'S STATEMENT OF RELEASE

In consideration of the modification(s) agreed to herein as complete equitable adjustments for the Contractor's.....(describe)..... "proposal(s) for adjustment," the Contractor hereby releases the Government from any and all liability under this contract for further equitable adjustments attributable to such facts or circumstances giving rise to the "proposal(s) for adjustment" (except for .....).

43.205 Contract clauses.

(a) (1) The contracting officer shall insert the clause at 52.243-1, Changes—Fixed-Price, in solicitations and contracts when a fixed-price contract for supplies is contemplated.

(2) If the requirement is for services, other than architect-engineer or other professional services, and no supplies are to be furnished, the contracting officer shall use the clause with its Alternate I.

(3) If the requirement is for services (other than architect-engineer services, transportation, or research and development) and supplies are to be furnished, the contracting officer shall use the clause with its Alternate II.

(4) If the requirement is for architect-engineer or other professional services, the contracting officer shall use the clause with its Alternate III.

(5) If the requirement is for transportation services, the contracting officer shall use the clause with its Alternate IV.

(6) If it is desired to include the clause in solicitations and contracts when a research and development contract is contemplated, the contracting officer shall use the clause with its Alternate V.

(b) (1) The contracting officer shall insert the clause at 52.243-2, Changes—Cost-Reimbursement, in solicitations and contracts when a cost-reimbursement contract for supplies is contemplated.

(2) If the requirement is for services and no supplies are to be furnished, the contracting officer shall use the clause with its Alternate I.

(3) If the requirement is for services and supplies are to be furnished, the contracting officer shall use the clause with its Alternate II.

(4) If the requirement is for construction, the contracting officer shall use the clause with its Alternate III.

(5) If a facilities contract is contemplated, the contracting officer shall use the clause with its Alternate IV.

(6) If it is desired to include the clause in solicitations and contracts when a research and development contract is contemplated, the contracting officer shall use the clause with its Alternate V.

(c) The contracting officer shall insert the clause at 52.243-3, Changes—Time-and-Materials or Labor-Hours, in solicitations and contracts when a time-and-materials or labor-hour contract is contemplated.

(d) The contracting officer shall insert the clause at 52.243-4, Changes, in solicitations and contracts for (1) dismantling, demolition, or removal of improvements; and (2) construction, when a fixed-price contract is contemplated and the contract amount is expected to exceed the applicable small purchase limitation in Part 13.

(e) The contracting officer shall insert the clause at 52.243-5, Changes and Changed Conditions, in solicitations and contracts for construction, when the contract amount is not expected to exceed the applicable small purchase limitation in Part 13.

(f) The contracting officer may insert a clause, substantially the same as the clause at 52.243-6, Change Order Accounting, in solicitations and contracts for supply and research and development contracts of significant technical complexity, if numerous changes are anticipated.

SUBPART 43.3—FORMS

43.301 *Use of forms.*

(a) (1) The Standard Form 30 (SF 30), Amendment of Solicitation/Modification of Contract, shall (except for the options stated in 43.301(a)(2)) be used for—

(i) Any amendment to a solicitation;

(ii) Change orders issued under the Changes clause of the contract;

(iii) Any other unilateral contract modification issued under a contract clause authorizing such modification without the consent of the contractor;

(iv) Administrative changes such as the correction of typographical mistakes, changes in the paying office, and changes in accounting and appropriation data;

(v) Supplemental agreements (see 43.103); and

NOTES

CHAPTER J

CLAIMS (And Resolution Thereof)

By the time we arrive at this chapter, the best laid plans of mice and men may have gone awry. Faced with differing interpretations of a contract, it becomes incumbent upon both parties to resolve the differences as quickly as possible. Failure to do so may jeopardize contract performance. Pending resolution of the problem, the contractor must continue to perform.

The contractor, in responding to a government-initiated change, may believe it has not received full equitable adjustment. The government may feel fully justified in providing x dollars instead of x + y dollars. After all, some contractors may use a modification to cover contractor inefficiencies on the original contract.

The Government must continually be aware of performing in accordance with standards required by due process of law. Failure to abide by these standards may result in losing appeals and, in some cases, paying the contractor's legal expenses.

The material which follows will be invaluable to all personnel involved in Contract Administration when claims or disputes arise.

	TOPIC	PAGE	ASSIGN
1.	Planning for the Negotiated Settlement of Claims, Robert Martin and Fred W. Geldon	J-2 thru J-19	Review
2.	Claims and Disputes, Robert J. Wehrle-Einhorn	J-20 thru J-44	Read
3.	The Disputes Process in Government Contracts Monograph No. 102, E.J. Smithson, Esq.	J-45 thru J-56	Review
4.	The Disputes Acts of 1954 and 1978	J-57 thru J-62	Review
5.	Case Study-P.L. 85-804: Waltham Precision Instruments, Inc., George Lemelin.	J-63 thru J-66	Review
6.	FAR and DFAR, Part 33, Protests, Disputes, and Appeals	J-67 thru J-76	Review

SCHOOL OF SYSTEMS AND LOGISTICS

ADVANCED CONTRACT ADMINISTRATION COURSE (PPM 304)

SUBJECT: Claims, Disputes, Termination

TIME: 7.0 Hrs

OBJECTIVE: Comprehend the various remedies available to the government and the contractor in contract disputes.

SAMPLES OF BEHAVIOR:

a. Explain the disputes process, DAR and FAR.

b. Describe the remedies afforded through the Executive, Legislative and Judicial Branches of the government.

c. Describe the organizations involved in disputes and terminations.

d. Define the importance of the significant procedure events leading to the Contract Disputes Act of 1978.

INSTRUCTIONAL METHODS: Lecture/Discussion
Case Analysis

STUDENT INSTRUCTIONAL MATERIALS: ACA Textbook

REQUIRED STUDENT PREPARATION: As defined by Chapter "J" of the ACA textbook.

5-31-82

Reprinted by permission from Federal Contracts Report, copyright 1982 by The Bureau of National Affairs, Inc., Washington, D.C.

(No. 934) K - 1

SPECIAL REPORT

FEDERAL CONTRACTS REPORT

PLANNING FOR THE NEGOTIATED SETTLEMENT OF CLAIMS

Robert Martin and Fred W. Geldon *

The government long ago decided as a matter of policy that it would try to exclude from the initial pricing of its contracts any amount to cover the contingency of cost increases resulting from government-ordered changes or other government interference with contract performance. The government, therefore, generally assumes the risk of such contingencies by providing — through contract clauses relating to design, performance, inspection, government-furnished material and property, suspension of work, site conditions, and the like — for an equitable adjustment in price when a government action or omission causes a contractor to incur increased costs.

Thus, despite the "bad press" it sometimes receives, "claim" is not a four-letter word. Rather it is an essential part of the government contract structure — the mechanism which permits the government to avoid paying for contingent costs which may never be incurred and which allows a contractor to be made whole should that contingency in fact take place.

However, while claims and their equitable resolution serve a desirable and beneficial purpose, the same cannot be said of disputes. Litigation is costly and disruptive, and almost always prevents both parties from realizing the full benefits of their bargain.

This article examines the whys and wherefores of negotiating the settlement of an equitable adjustment request, recognizing that claims are inevitable, that litigation is not, and that planning for the negotiated settlement of an equitable adjustment request is a process which furthers the best interest of both the contractor and the government.

"The first thing we do, let's kill all the lawyers."[1]

Perhaps because lawyers litigate, there is an assumption that they are litigious. In fact, there are very few experienced lawyers in the government contracts field who would not advise that an early and reasonable settlement of a claim is preferable to all but the most outstanding litigation victory.

Both the government and the contractor have compelling interests in assuring that their key personnel are available for the productive and administrative mainstream, not bogged down in the byways of litigation. Moreover, in today's economic climate, a cost conscious government will recognize that litigation is not without cost to it; that a policy hostile to reasonable settlements will drive up the expense of contract administration and, ultimately, of procurement.

A contractor who conducts his business so that he is in a position to recognize his rights to an equitable adjustment at an early point and even to forewarn the government of the possible consequences of its action makes a genuine contribution to the procurement process, as well as to his own financial protection.

Moreover, most of the steps that a contractor must take to cope effectively with the equitable adjustment process are also those which enhance contract administration and production control. In many instances a contractor's existing procedures can be adapted for the equitable adjustment process, allowing company management quickly to decide whether, when, and what kind of claim should be filed.

---

* Mr. Martin and Mr. Geldon are partners in the Washington, D.C., law firm of Leva, Hawes, Symington, Martin & Oppenheimer and practice in the government contracts field.

Copyright © 1982 by THE BUREAU OF NATIONAL AFFAIRS, INC., Washington, D.C. 20037

0014-9063/82/$00 50

The Government Side Of The Negotiation

A. *An Overview*

In order to understand what a contractor *should* do when he submits a request for an equitable adjustment, it is first necessary to understand what the government *must* do when it receives a request for an equitable adjustment.

The basic authority for dealing with an equitable adjustment request lies with the contracting officer. Depending upon the particular procurement and the nature of the equitable adjustment request, "contracting officer" may mean the administrative contracting officer (ACO) or the procuring contracting officer (PCO).

Whichever it be, the designated contracting officer plays a variety of roles. These roles are not radically different from those one might expect in a normal business negotiation with a commercial contracting partner faced, for example, with a request for a price increase because of a change in contract specifications. (Of course, unlike a government contract, commercial negotiation generally does not presuppose an obligation on the part of the contractor to perform the changed work; rather, that obligation itself may become a negotiable item.)

One would expect that the responsible official in a commercial contract would review a request for price increase and, to the extent cost effective, investigate the factual, legal, and pricing basis of the request. Since a competent, responsible official would seek an accurate understanding of the situation to prepare himself for a potential dispute, his investigation would be in part objective and in part adversarial.

After reaching preliminary conclusions and possibly while still investigating, he would "negotiate" — i.e., conduct discussions appropriate to the circumstances to obtain an amicable resolution of the matter. In those discussions he would be an adversary; but if the business relationship were of any consequence, or if he were concerned about his organization's reputation as a contracting partner, he would attempt, in the broad sense, to be fair even while obtaining a "good deal" for his organization.

If agreement could not be reached, he might tell the claimant to follow the contract's provisions governing dispute settlement in court or arbitration. In that posture, he would be analogous to the initial "judge" rendering a decision because the contractor, to recover, would have to get that "decision" overruled. In the commercial situation the claimant might go "up the line" in the company, bring the necessary legal proceedings, or both.

Much the same course follows with the government, except that it is more structured and detailed. The contracting officer, who is governed by an explicit set of contract clauses and regulations, has less flexibility. His actions may be subject to closer scrutiny. Extraneous business considerations cannot play as meaningful a role in settlement.

Faced with these constraints, a contracting officer may need help in reaching what he perceives to be the fair result. The more sophisticated and experienced he is as a contracting officer, the more open he is likely to be in considering both what is equitable and how that may be accomplished.

In reaching a settlement, a contracting officer is charged with a responsibility of fairness as well as legality. The Navy's Procurement Directives provide a good statement of what the government's view should be. In this particular directive, "claims" is defined narrowly, to include only requests for equitable adjustments based on constructive changes — those that result from government conduct other than from formal, written change orders. This same approach would, of course, apply to explicit change orders.

The Navy states:

> Delay in resolution of contractor claims can produce a serious impact upon the business relationship between the Navy and certain of its major contractors.
>
> * * *
>
> Acquisition programs must be conducted in a manner calculated to minimize the occurrence of claims. Further, those claims which arise despite appropriate precautions must be resolved as promptly as prudence permits by those most directly involved. The causes of claims must be minimized through realistic planning and contracting, careful attention to the action required to meet the Navy's obligations and tight control over the changes process. *Occurrences which may lead to claims must be recognized as they happen and appropriate action initiated promptly. Elements of Naval activities at all levels are expected to*

Copyright © 1982 by THE BUREAU OF NATIONAL AFFAIRS, INC., Washington, D.C. 20037
0014-9063/82/$00.50

face claim situations squarely, report them to the appropriate levels of management, take prompt action to get the facts, make an objective analysis, and seek prompt resolution. Dealing will be fair and open with the expectation of equal consideration from contractors. (Emphasis Supplied.)[2]

Thus, one can expect that a contracting officer will try to be equitable, as he and his team perceive that equity, within the framework of the regulations that govern his action.

The problems — and the opportunities — of settlement may lie in that perception. A critical task for the contractor, therefore, is to help the contracting officer and his team overcome any blind spots that may exist from having experienced only the government's perspective of the contract.

B. *The Ground Rules*

The contractor must understand with whom he is to negotiate and the context of that negotiation. The doctrine of apparent or implied authority generally does not apply to the government. The ACO's settlement authority is dependent upon delegation from the PCO. The contractor will want to know the authority of the contracting officer with whom he is dealing, including any business (e.g. dollar) limitations on settlement authority and any limitations due to funding. He will also want to know what the levels of review are and how they will be affected by dollar limitations or other considerations. Much of this information may be obtained simply by inquiry. Depending upon assignments and delegations of authority, a contractor dealing with an ACO may find that the ACO has to clear decisions with a PCO, or that he may be getting technical or contractual input from the PCO or his staff. The ACO must always deal with the PCO on funding matters, and funding considerations may prove to be a key element in the settlement process.

In dealing with a claim of any size or complexity, the contracting officer will be assisted by a team that will include contracting, audit, technical, pricing, and legal representatives. While the team's role is advisory and it is the contracting officer who has the decisional authority, the action of a team member can be crucial to the process, as, for example, when the Defense Contract Audit Agency formally disallows certain costs. As another example, under the Army Procurement Procedures the lawyer is given a critical role:

> While the contracting officer is the exclusive agent of the government for entering into and administering contracts and is responsible for coordinating his team of advisors, he is not completely free to evaluate the legal advice of his legal counsel and act in a manner inconsistent therewith. The contracting officer can not properly make an award of a contract which fails to meet all legal requirements. If a proposed course of action is determined by procurement legal counsel to be legally insufficient, the contracting officer shall take steps to overcome the legal objections to the proposed action. Failing such resolution at purchasing office level, the contracting officer shall refer the matter to the cognizant head of procuring activity for resolution.[3]

The reviews to which a contracting officer must submit his proposed settlement vary from agency to agency. The Army Procurement Procedures, for example, provide that any contract modification of $10,000 or more must be submitted to a Board of Awards, while the Defense Logistics Agency requires review of ACO actions with respect to contract modifications having a total cost of $250,000 or more. The DLA regulations are instructive not only because of the number of contracts to which they apply, but because they illustrate what the essential process will be, regardless of the agency and contract involved or the precise details of other applicable regulations. Under those regulations, the ACO must submit the following information to the DLA Board of Review:

(a) A memorandum or letter submitting the proposed action.

(b) The price negotiation memorandum prepared in accordance with DAR 3-811 and Section 3-811 of this manual, supported by the following documents as applicable:

1. Contractor's proposal.
2. Cost/price analysis report.
3. Certificate of current cost or pricing data executed by the contractor.
4. Technical evaluation reports.

Copyright © 1982 by THE BUREAU OF NATIONAL AFFAIRS, INC., Washington, D.C. 20037
0014-9063/82/$00.50

5. Audit report.
6. Statement as to legal sufficiency from DCASR Counsel.
7. Copy of fund certification.[4]

The DLA Board's role is advisory, and the scope and intensity of each review varies with the nature of the action being considered. While the Board "may have reason to examine the individual items comprising the transaction," the DLA manual points out that "the Board must keep in mind that it is concerned with the merits of the transaction as a whole."[5]

An ACO who does not wish to follow the Board's recommendations must submit his decision and the rationale for it in writing to his supervisor before taking final action.

This regulatory world in which the contracting officer functions also dictates how the contractor must function. A settlement may be arrived at in broad dollar terms, but it must be documented in great detail. The better the job the contractor does in his submission, the less the contracting officer's team will have to do in its review. It is that team which will provide much of the material the contracting officer will submit in support of any proposed settlement. While the role of the team is advisory, the contracting officer is not going to depart from that advice unless he is convinced it is wrong; even then he will proceed with caution.

Therefore, the contractor must himself have a team of experts, from inside or outside his own company, and often both, and must recognize that he has considerable homework to do to support a claim. Naked advocacy will not suffice. Moreover, the negotiation is not with just the contracting officer, but is conducted throughout the audit, technical, legal, and pricing review.

For claims that run into the hundreds of thousands or millions of dollars, a contractor must structure his organization to provide the government with the information necessary to support his claims. The government will not do the contractor's homework. The contractor will have to persuade the various government experts who form the team, as well as the contracting officer, of the substantive validity of the claim and of the reasonableness of the amount sought. The legal role here is essential, both to cast the claim in a legal context satisfactory to the government and to help the other team members develop relevant evidence. The earlier and more carefully this information is prepared, the more likely and prompt the settlement. It simply invites litigation to defer doing the homework until late in the game only to find that the claim requires substantial restructuring, or that the contracting officer has reached a position which appears to be frozen.

Claims that are comparatively low in amount (and which are not out of proportion to the original contract price) will as a practical matter have to endure less critical reviews, but technically are subject to the same legal and regulatory requirements as a large claim. Moreover, even small dollar claims may have serious, and often differing, precedential effects on one or both parties that may prompt them to seek or to avoid a litigated decision. In doing business with the government on even small contracts or claims for small amounts, therefore, a contractor must be prepared to cope with this complex structure and make sensible, dollar-oriented decisions on how he will pursue his claims.

The Planning Starts Before The Contract Is Awarded

A contractor who does not plan in advance how claims will be handled will find himself playing "catch-up ball" when they arise and in fact may fail to recognize a potential claim in time for the government to make the choices that will mitigate potential damages.[6] Moreover, a contractor who, as they occur, tells the contracting officer that certain contemplated government actions or omissions will result in increased costs stands a better chance of being reimbursed for those costs than one who discovers the problem only late in the performance period. In contrast, a contractor who discovers his claims late in the day, essentially as part of an analysis of the cause of major cost overruns or schedule delays, invites the accusation that what is being sought is a "bail-out" rather than an equitable adjustment. Thus, an unnecessary hurdle has been put in the way of settlement, even though the claim may be meritorious.

Copyright © 1982 by THE BUREAU OF NATIONAL AFFAIRS, INC., Washington, D.C. 20037
0014-9063/82/$00.50

In short, lack of advance planning — including an understanding of "base-line" requirements, imposition of cost and schedule controls, and coherent contract administration and communication — will delay and impair the contractor's ability to submit a valid claim and will diminish his bargaining position when he negotiates that claim.

A. *The "Base-Line"*

From the beginning, a contractor must understand the "base-line" definition of his obligations under the contract. Contract terms and drawing and specification requirements are not always clear or consistent. Just a quick look at the voluminous litigation over what constitutes a "change" or on the allocation of responsibility for an inconsistency between a drawing requirement and a specification performance requirement shows how commonplace is the lack of clarity. While the government may well be responsible for an ambiguity in the procurement, litigation may be necessary to resolve the issue. A contractor is far more likely to have a successful contract if ambiguities are resolved before the contract is executed.

Even obligations thought to be unambiguous may be seen differently by different contractor personnel. "Sales," "production," "engineering," "administrative," "accounting," and "legal" personnel may have quite different perspectives about the same contract provisions. Only by establishing a common understanding among his own personnel can a contractor be assured that everyone is marching to the same drumbeat and that his pricing of the contract is based upon that common understanding.

Since the establishment of the "base-line" determines how the contract is priced, performed, and administered, one would expect that this task would be carefully undertaken by the major government contractors. Sometimes, however, time constraints or complexity of a procurement, or even the cost of a comprehensive review, make adequate analysis difficult or even impossible.

Moreover, with the Defense Department seeking rapidly to upgrade its readiness and to develop more advanced technology, the acquisition process itself can increase the likelihood of design instability in major new weapon systems, exacerbating the ambiguity of contract obligations. The compression of time for the design and construction cycles often results in "design-production concurrency," a euphemistic description of a situation guaranteed to breed misperceptions and claims.

The pitfalls inherent in such circumstances require a contractor, for his own and the government's protection, to be able promptly to recognize significant changes in the contract tasks. This can be done only if those tasks are properly defined and understood at the outset. When a contractor finds out after the fact that his perception of the "base-line" differs from that of the government, or even from those of some of his own personnel, he is likely also to find that there are substantial cost overruns, that the recovery process will be arduous, and that seeking recovery will cause substantial strains in his relationship with the government.

Although there are times when ambiguity in contract requirements may be the lesser evil, it normally creates a high risk situation which should be avoided. To the extent the base-line cannot be clarified before the contract is executed, it should be clarified at the earliest feasible date after performance has begun.

In any event, the contractor must establish his position as to the contract's intent, both within his organization and, if possible, with the government. Otherwise, there may be commitments made with respect to the engineering, purchasing, and production plan of the contract that are costly or even impossible to undo or modify. It is not unusual for the contract "proposal" or "negotiation" group to be separate and distinct from the contractor team that will manage performance. Similarly, there may be different personnel dealing respectively with prime and subcontract matters. The assumption that all are proceeding with a common understanding of the contractual requirements is often erroneous.

Different perceptions of the base-line may lead the contractor's personnel to take prejudicial actions without recognizing that the need for doing so stems from a problem which the government created and which therefore may constitute a "constructive change." Those actions may include correspondence or even agreements with the government that later could

Copyright © 1982 by THE BUREAU OF NATIONAL AFFAIRS, INC., Washington, D.C. 20037
0014-9063/82/$00.50

prevent recovery of the cost increases. Conscientious employees of the company may feel — and express —"mea culpa" attitudes when problems arise, not recognizing that the source of the problem is external.

B. *Cost and Schedule Controls*

In a contract of any size or complexity, a contractor must do scheduling and production sequencing work even before the contract is executed. In some instances, planning and scheduling will be subject to specific government requirements, including reporting requirements governing both progress and costs.[7] Cost Schedule Control Systems (CSCS) which include a detailed production plan are not uncommon. In the course of the contracting process and early stages of production, these processes may be substantially refined. Whether by CSCS, a PERT[8] network, a Critical Path Method (CPM)[9], or even a less sophisticated bar chart, the contractor must have some form of schedule by which he can measure performance. And he must have some budget against which he can measure costs incurred.

Not every contract justifies requiring the same complexity and detail in schedule or cost control. In large contracts, some contractors, using PERT simulation modeling techniques, have gone so far as to develop computerized simulation models[10] of their production system, using man-loading estimates, providing for possible "work-around" alternatives to interference, and determining, on a probabilistic basis, the contractor's ability to meet cost and schedule objectives. Thus, when one adds to such a simulation a series of government-ordered design changes (with their "direct" work requirements), one may be able to predict the disruptive effects of those changes to the production system.

Of course, a contractor must adapt to the realities of the particular procurement process in setting the sophistication of the system which he utilizes to control production and schedule. Assuming that the contractor's scheduling and estimating material is commensurate with the contract itself, a control system will serve two principal purposes:

First, it will show variances which indicate that a problem may exist, allowing the problem to be monitored at an early date. This may simply tell the contractor how he must shift his resources to meet his contract obligations — or it may reveal that there has been a departure from the base-line, as a result of some government action or omission.

Second, it will show the interrelationships of the various activities the contractor undertakes to meet his obligations under the contract. Detailed PERT or CPM systems not only allow the contractor to manage production more effectively, but also can help forewarn that interference in a particular area may ripple through the program.

Armed with that knowledge, a contractor may be able to anticipate and mitigate the disruption in production, or even avoid it by persuading the government to delay or eliminate its proposed action or to extend the delivery date. Moreover, the opportunity to measure the impact of the disruption, including costs and schedule, also offers the opportunity to plan this additional work. In any event, the contractor is able to put the government on notice at an early stage that its proposed action could be costly and likely to result in a substantial equitable adjustment.

In short, the controls a contractor puts in place at the outset to plan production are an important part of the structure leading to successful negotiation of the requests for equitable adjustments that may subsequently be necessary. Within the limits that time constraints, money, and personnel impose, the tighter the control that the contractor has in this area, the better able he will be both to carry out his performance obligations and to recognize, price, and negotiate government-caused interferences to that production system.

C. *Administration and Communications*

Prior to contract award and again in the early planning afterward, a contractor must set up procedures to control and review his communications with the government. On a sizable and complex contract, it may be impossible to limit communications to a single channel, but that is the ideal and anything short of it — however unavoidable — will lead to problems which

Copyright © 1982 by THE BUREAU OF NATIONAL AFFAIRS, INC., Washington, D.C. 20037
0014-9063/82/$00.50

the contractor must anticipate. Failure to speak with one informed voice may seriously impair a contractor's ability to deal with government actions that justify equitable adjustments. Decisions which should be made by the executive may be foreclosed by inopportune and even inaccurate correspondence or other communications with the government by other company personnel.

On a contract likely to have significant equitable adjustments, the contractor should plan from the beginning how he will staff such matters. Because this task is not considered "productive," and because of the general hostility to claims on the part of both the contractor and the government, this function is too frequently downgraded and treated as if it were an annoying appendage to serious production efforts. However, it is part and parcel of doing business with the government and can have very large bottom-line consequences for the contractor.

It is not unusual to see company engineers or production personnel reach agreements with the government which amount to departures from the base-line without recognizing that to be the case — not because they are badly motivated but because their attention is focused on problem-solving and not on bottom-line responsibility. It is not unusual to see units accepted on waivers to avoid delaying shipment when, in fact, the inspection requirements which give rise to the need for a waiver departed from the base-line. Nor is it unusual to see progress reports ascribe delays or cost overruns to some visible events when a more thorough analysis would show they were the product of constructive or explicit changes which rippled through the production system.

Once again, the kinds and the functions of the personnel involved do not differ significantly from those needed simply to manage the contract and deal with the government in an orderly manner. But a recognition of the possible impact that contract administration may have on a contractor's profits should cause him to seek well-qualified personnel and to provide an adequate staff for this function. Only with such assistance can the contractor's executives preserve for themselves the opportunity to make the decisions on how the company should deal with the government when significant departures from the base-line occur.

Someone must perform the role of a contract administrator to deal with the large flow of paperwork. If the paperwork is not carefully coordinated, company executives will not be adequately informed as to the kinds of commitments or positions that the contractor is undertaking with the government, and key personnel will not be on notice of potential claims and their costs.

The contract administrator must have input from production, scheduling, engineering, quality control, accounting, and legal personnel familiar with the contract, including notice when a possible departure from the base-line is occurring. Depending upon the size of the company and the structure of its programs, the contractor may best be served by a separate contract analysis and negotiation group which has its own industrial engineering support to review such problems. In any event he will need the capacity to analyze and bring to the attention of the executives managing the project any potential departures from the base-line. With their guidance, the contract administrator has a critical role in advising the government when an equitable adjustment may be involved. To communicate this information effectively, he will need additional help from various other disciplines to describe and at some stage estimate the problem.

It cannot be stressed too strongly that no brownie points are gained by deferring the facing of a problem with the government simply because it may involve a claim for an equitable adjustment. On the contrary, the contract clauses which govern these matters, and which come into effect the day the contract is executed, call for early notice. Failure to give timely notice can, in fact, deprive the contractor of some or all of his rights to an equitable adjustment.

Thus, in addition to requirements that simply make good business sense in terms of advance planning, the contractor must also deal with the contract clauses themselves that bear on these concerns. To be prudent, he must carefully consider them prior to contract award. For example, one clause requires the contractor to have an accounting system that can segregate the costs of a change.[11] While this is desirable, it will be feasible only when a change is

Copyright © 1982 by THE BUREAU OF NATIONAL AFFAIRS, INC., Washington, D.C. 20037
0014-9063/82/$00.50

not mixed in with other work and can be discretely performed with no impact on unchanged work. But, where the change is mixed with other work, especially if it has any ripple effect, segregating costs is virtually impossible as an accounting matter; one must depend on engineering estimates. Therefore a contractor faced with such a clause will have to resolve this issue with the government and establish, prior to contract award, accounting procedures that are acceptable to both parties.

Similarly, a contract may call for the pricing of changes before they are implemented.[12] The entire performance schedule and costs of a contract can be disrupted simply because of the time lag which such a process requires, unless a contractor can negotiate an acceptable substitute clause or else gear his organization for that procedure. Other contract clauses require a contractor to estimate and perhaps put a ceiling upon any equitable adjustment requested, prior to performance of the work.[13] Again, with such a clause the contractor must have the procedures and personnel in place to make compliance possible and effective. Alternatively, some contract clauses[14] and regulations [15] recognize that delay and disruption costs may not be capable of current estimate and allow reserving them for settlement later.

Care must also be taken in establishing procedures for keeping records and a potential claims file. This claims file should contain documentation that can be used to support the claim (or refute defense to it) in negotiations and, if necessary, litigation. It should contain, as appropriate, precontract and contract documents, amendments, audit reports, communications and meetings, cost or price data, and inspection reports. Sensitivity should be shown, however, with respect to possible later disclosure of material in the file, particularly where documents may be protected by, for example, the attorney-client privilege or the work product privilege.

Since the systems that are involved for dealing with possible claims are the same as those that are necessary to run the contract, their costs, whether based upon the services of in-house personnel or outside consultants, should be allowable. In any event, they are necessary and worthwhile expenditures.

Claims Preparation

It hardly needs stating that the critical steps in claim preparation are the identification of the claim and its pricing. But it should also be evident that, depending upon what has gone before in terms of the contractor's control system, and depending on the nature and circumstances of the claim, a potential claim may be highly visible or it may be quite obscure, and its true costs may have similar characteristics.

If the contracting officer issues a directive under the Changes clause, issues a Suspension of Work Order, or takes similar formal action authorized by the contract, the fact that a claim may exist is immediately apparent. The invitation to start the claims preparation process is unmistakable.

The right to assert a claim, of course, quite often arises without formal action by the contracting officer, as when, for example, government drawings or specifications prove to be defective, resulting in a "constructive" change claim under the standard Changes clause. Claims resulting from a government action or omission not containing a formal invitation for claims submission can arise under a number of standard contract clauses (e.g., Changes, Government Furnished Property, Suspension of Work) and can require extensive factual study of what has occurred as well as legal analysis as to who must bear the responsibility. Even where some aspects of a claim are apparent, the government's action or omission may also have caused delay, disruption, acceleration, or the like, and the nexus may be obscure at the outset.

Moreover, regardless of whether formal government action was involved, the resultant costs may be discreet and readily calculable or may ripple through the entire production system and be ascertainable only through the use of sophisticated industrial engineering analysis.

The better the contract control processes in place from the contract's inception, the easier it will be to discover and measure the full range of effects of the government's action or

Copyright © 1982 by THE BUREAU OF NATIONAL AFFAIRS, INC., Washington, D.C. 20037
0014-9063/82/$00.50

omission. The scope of the factual and legal analysis necessary for identifying, justifying, and pricing the claim will depend both upon how it arose and how it may have affected the contractor. The resources required to present a claim appropriate to the circumstances will depend upon the dimensions of the contract, the government's actions or omissions, and the contractor's advance preparation.

Numerous articles have been written relating to particular types of claims and the methods for pricing them. With so many variables in the types and circumstances of claims, and how they should be priced, it is possible only to review briefly some of the sources of information to be considered in performing the necessary analyses and some of the considerations that generally are pertinent in preparing and submitting a claim.

A. *Factual Analysis*

The focus of the factual investigation is on determining:

1. Where and to what extent contract performance differed from the contract base-line requirements;

2. Why such departure from the base-line requirements occurred.

Depending upon what precipitated the claim process, of course, the investigation will vary greatly. In a case of advance pricing of a formal change order, the investigation will focus on how that change order will affect the contractor's work and will require industrial engineering prediction rather than after-the-fact gathering of information. At the other end of the spectrum, the contractor may find that his costs of performance are well above expectations, that there have been substantial production problems and delays in performance, and that, beyond some recognizable changes in the scope of work, he doesn't know why the overruns occurred. We shall direct our attention to the latter situation, knowing that the reader would pare down his investigation to that justified by the circumstances.

There are two basic approaches to the factual investigation. One is essentially analytical, providing an overview of contract performance to point the contractor toward those areas of contract history which may be most pertinent. The second involves interviews of personnel and review of contract documents to determine in detail what occurred and why. The timing of these approaches normally overlaps to some degree, and both are involved in most cases. There will always have been some preliminary interviews which may provide insights into the appropriate direction of analysis. Since the analytical approach can act like a compass in the investigation, we will begin with it. The basic analytical tools are as follows:

1. The contractor's basic cost records should yield his labor and material cost broken down into detailed cost categories. A comparison of that information with the contractor's bid or proposal estimates will point out the areas of cost growth. While in delay and disruption situations the growth may spread throughout the entire production process, the areas of significant cost growth would nevertheless be expected to relate most closely to those areas of contract performance where the greatest problems existed. Of course, this will not tell why that cost growth occurred in those particular areas, since it will be consistent with contradictory theories — that the contractor underestimated the cost of performance in the first instance, or that there was significant external interference, possibly government-caused, in the particular areas involved.

2. In order to control performance, the contractor will have used one form or another of scheduling systems. For larger and more complex contracts, some sort of network analysis or PERT system may have been used. By comparing actual performance with scheduled performance, it is possible to determine the general areas and times where delay occurred, and perhaps even to pinpoint the particular work areas which required additional time for performance. Depending on the kind of scheduling system used, the contractor may be able to track interrelationships in delay, and thereby trace back to the actual points in the production system where interferences occurred on the critical paths, to find the sources of those interferences. It should be apparent that, with respect to both schedule

Copyright © 1982 by THE BUREAU OF NATIONAL AFFAIRS, INC., Washington, D.C. 20037
0014-9063/82/$00.50

and costs, the better the system in place at the outset of performance, the more quickly and accurately a contractor will be able to analyze where the costs increased and where his program was delayed. This will allow him to turn to why the cost increases and delays occurred.

3. When changes in the scope of work are thought to be the culprits, an overall analysis of the drawings and specifications may be in order, to ascertain the differences between work as contracted and as built. Again, further analysis will be required as to why those differences occurred.

With the benefit of cost and schedule analyses, and possibly the as-contracted-as-built drawing and specification analysis, a contractor can turn to the more traditional tools: interviewing personnel and reviewing the documentary history of the contract. At times, individuals, including authors of the documents, and, therefore, the documents themselves, will provide insight as to sources of the performance difficulties. Often, however, those closest to the program may not see the forest for the trees, and, as noted earlier, may not understand the contract's base-line. Their focus has been on solving problems and getting the job done, rather than on claims potential. At times such individuals accept blame where none is due, or may seek to shift responsibility from themselves and point it in the wrong direction. Thus the interviews and documentary review must be performed with a careful skepticism. It must be remembered that the objective of factual analysis is to determine what actually occurred, leaving to a later stage any decision as to which of the potential claims are appropriate for presentation.

With these caveats in mind, the review of contract history can entail the following:

1. Interviewing contractor personnel knowledgeable about the program and its problems. Sometimes, group interviews are useful, allowing cross-fertilization of memory. Using the results of the analytical tools described above, the contractor can determine how reliable the information is that he is receiving in the preliminary interviews and who the most knowledgeable, reliable, and resourceful sources of information are. The combination of the analytical tools and the interviews should give a good indication as to where in the documents the contractor is likely to find additional useful information.

2. Reviewing the contractor's documents, including all of the bid or proposal data, and memoranda relating to precontract discussions. A study of these should allow the contractor to confirm or modify his understanding of the base-line in the critical performance areas. This is also true with respect to the contracts with his subcontractors or suppliers to the extent they may be pertinent.

3. Analyzing correspondence between the contractor and the government, as well as the internal correspondence among his own personnel, to determine whether they reflect the departures from the base-line gleaned from the earlier analysis and interviews. Progress reports may be particularly significant because they reflect the contractor's statement to the government on a regularized and formal basis, of what has occurred. It cannot, however, be stressed too strongly that quite often the personnel preparing such reports do not have a broad enough perspective of contract performance to know what in fact occurred. This is particularly true when the contractor's performance monitoring system is not geared to provide such information.

4. Reviewing on a selective basis, the documentation in the engineering, tooling, production, quality control, schedule control, and other areas. Ultimately, this may involve review of log books, journals, photographs, and the like. The nature of the claim, the dollars involved, and the ready availablity of information the contractor believes is sound, will, of course, determine the scope of the review.

5. Seeking government documents not in the contractor's possession, which the contractor believes can yield important information. The simple approach is to ask for those documents, and, if the contracting officer declines to provide them, to request them under the Freedom of Information Act.

Copyright © 1982 by THE BUREAU OF NATIONAL AFFAIRS, INC., Washington, D.C. 20037
0014-9063/82/$00 50

Again, a cross-disciplinary team may be needed to review the facts from different perspectives. The team may include the contract administrator as well as representatives of the engineering, production, quality assurance, accounting, and legal areas.

In some cases, much of this detailed analysis may be unnecessary, particularly when there is only a small claim at stake and there is someone with a complete and accurate knowledge of all relevant events. But in larger, more complex matters, no one will fully know or remember the details of the production problems, much less the details of pre-contract discussions so critical to the contract base-line. It is here that the contract management mechanisms are so vital to claims preparation.

B. *Legal Analysis*

To recover on a claim, it is not enough that a contractor's performance exceeded the requirements of the contract. He must also demonstrate that the government's conduct was responsible, either directly or indirectly, for the need to perform the extra work. The simple case is where there is a specific government directive. Let us assume, however, a case in which added work is not specifically requested but results from some other conduct by the government, such as when performance is delayed by factors for which the government is responsible, yet it refuses to extend the performance schedule. This forces the contractor to perform more quickly and may in turn require additional hiring and overtime and reduced efficiency, increasing the contractor's costs. Although it has not directly required the increased labor costs, the government is nevertheless responsible for an acceleration claim.

The importance of being able to assign "responsibility" to the government cannot be over-emphasized. A claim will not succeed when the extra work was performed voluntarily, or when the contractor has misunderstood the contract requirements. This again shows the importance of tight controls over contract communications and base-line. If communications are carefully monitored, the contractor's representatives will not later be said to have made admissions that the added work is being done voluntarily. In the acceleration situation, for example, those communications should show that the contractor indeed requested but was refused a time extension, rather than merely that the contractor was attempting to make up lost time.

Although the ability to assign responsibility to the government is a prerequisite to recovery, the analysis does not end there. Some contracts, in an attempt to limit liability, contain disclaimers of government responsibility. These include clauses disclaiming warranties as to the condition of Government Furnished Property or requiring the contractor to investigate the construction site, as well as more indirect attempts to disclaim any warranty of drawings or specifications. There are even occasional attempts to limit the filing of claims entirely. An example is the Notification of Changes clause, which may be used in supply and R&D contracts for more than $1 million. This clause substantially limits the time period during which a claim may be filed to a certain number of days following "identification" of a change.

The government may also have a defense if the contractor has previously signed release language — perhaps on a totally different claim — that arguably might encompass the new one. Although courts construe releases narrowly — especially where the parties did not affirmatively intend that the release cover the new claim — careful analysis should be given to possible release problems, for they may prove to be important in considering how the claim should be presented.

C. *Pricing*

Pricing of a claim is both an art and a science — but it is not guesswork.

From the contractor's accounting records, one can determine material costs, hourly direct labor rates by various classifications of employees, and various rates for indirect costs such as overhead and general and administrative expenses. Cost Accounting Standards, as well as the procurement regulations, will govern much of the basic accounting effort and the allowability of particular costs.

Copyright © 1982 by THE BUREAU OF NATIONAL AFFAIRS, INC., Washington, D.C. 20037
0014-9063/82/$00.50

Under most elaborate accounting systems, unless the increased costs caused by the government actions or omissions are discrete and segregable, a claim rarely can be priced simply on cost accounting records. Even for relatively simple changes, such as increasing the size of a bevel or of a drilled hole, one must turn to industrial engineering assistance to determine the actual cost to the contractor in direct labor hours (to which the accounting data will attach). Thus, while accountants have an important role to play in claim pricing, pricing generally is not simply an accounting function.

The nature of the claim, and the types of records and controls maintained by the contractor, as well as how the particular government actions or omissions and their timing affected the contractor, will dictate what type of pricing effort is feasible. Cost estimating systems vary widely; for example, estimates can be based on time and motion studies, return costs, characteristics estimates such as dollars per pound, industry standards, "building block" techniques, use of learning curves of various types, and the like. Different techniques and different estimators can lead to significantly different results, even though the estimates are being made in good faith. On major claims, it may be desirable to use more than one estimating approach in order to provide a negotiating range.

The differences stemming from techniques and judgments are exacerbated when there are differences of opinion as to how a particular action or omission in fact affected the contractor, and whether some of the costs which might otherwise be claimed should be attributed to causes for which the contractor must bear responsibility. For example, when a contractor asserts that he was delayed, disrupted, or accelerated, with all of the related costs, the issue almost inevitably arises as to what truly caused the inefficiencies being priced in such claims. In this situation there can be an important relationship between the justification for the claim itself and the pricing methodology chosen. For example, where PERT simulation modeling techniques are used, the effects of government actions or omissions may be displayed and measured on a probability basis. Thus, both cause and cost are involved.

Similarly, while a series of government actions or omissions, considered on an isolated one-by-one basis, may be relatively simple to estimate and price, those acts or omissions may be interrelated in their effect upon the contractor's performance. In considering how a planned, orderly production or construction system was delayed, disrupted, or accelerated, there is often a synergism wherein the total impact of the government's actions is greater than the sum of those actions considered individually. Such claims are often the most controversial, yet it is in these areas that the contractor may incur his greatest costs. Where disruption, delay, or acceleration are laid at the government's doorstep, whole new areas of costs may be brought within the claim area, such as overtime costs, loss of learning, increased overhead costs for the extended production period, increased rates for work performed at a later date, etc. Claims under one clause (e.g., Changes), also may trigger claims under another (e.g., Escalation). The industrial engineering studies relating to pricing thus may reveal for the first time the true dimensions of the claim.

The fact that pricing may be difficult, and at times somewhat abstruse, does not relieve the contractor of his burden of proof (although it may change what is legally acceptable to the government). A contractor may not simply state that his bid price was "X," his total costs were "Y," the government did a series of horrible things, and the contractor is, therefore, entitled to the difference. "Total cost" and "jury verdict" pricing may be used only under limited circumstances. Thus, a contractor not prepared from the beginning to track his performance in terms of departures from the base-line may find it very difficult after the fact to prove that the full extent of his increased costs must be borne by the government, or even to understand that the government caused certain costs to be increased. Lest we overstate, even a good tracking system in place can require extensive additional effort to support the claim, but it will improve materially the opportunity to relate cause and effect, and to tie costs to these effects.

Because of all the possible variables, it is beyond the scope of this article to describe how to price a particular claim. Several points, however, are applicable to all claims:

Copyright © 1982 by THE BUREAU OF NATIONAL AFFAIRS, INC., Washington, D.C. 20037
0014-9063/82/$00.50

1. A contractor is entitled fully to price his claim based upon his reasonable costs under the circumstances, and should not be embarrassed to claim costs incurred due to a government act or omission, even though another contractor in other circumstances may have been able to deal with the problems in a less costly manner.

2. A contactor in most instances cannot be expected to do other than rely upon a reasonable estimating system for determining what the costs of a particular government act or omission may be, but recovering those true costs will depend upon the contractor's ability to provide well-supported estimates.

3. Reasonable estimating generally involves combining established statistical and industrial engineering techniques with accounting data, with an appropriate form of cause-and-effect justification. The government may not ignore the synergistic effect of a group of change orders, nor demand that they be priced on an isolated change-by-change basis.

4. The contractor always must bear in mind that when he claims increased costs he bears the burden of proof; it is rare indeed the government will suggest that the contractor has under-priced his claim.

D. Claims Presentation

Once the contractor has identified the areas of performance in which the government has caused extra work, he must turn to strategic and tactical considerations. Not all claims are equally strong. Some may be susceptible to clear and persuasive proof; others may be more uncertain as to entitlement (government responsibility), quantum (estimate of added costs), or both. Few claims are 100 percent clear. Most have areas of uncertainty or ambiguity — legal arguments on both sides, factual premises that cannot easily be proved. Reasonable people may differ as to their appropriate outcome or value.

While a contractor may not file a frivolous or fraudulent claim (neither ethics nor the various required certifications would allow it), a claim is not frivolous merely because it is not 100 percent certain of proof. Obviously, the choice of which claims to file will depend on size and ease of proof; the highest priority will be reserved for those claims most likely to result in the greatest recovery. Beyond that it is difficult to generalize. Sometimes the inclusion of smaller, weaker claims will delay and jeopardize the credibility of the stronger ones. Other times, smaller claims can provide useful bargaining chips. The key point is that the choice of claims to be filed should be made with the awareness that after filing there will be much give-and-take in negotiations with the contracting officer.

As for the presentation itself, the most important point is that it is not enough to be conclusory — rather, the contractor must present a full factual and legal basis for recovery.

While there is some flexibility as to *format* a claim should generally contain the following:

— a summary of the claim, "telling the reader what you are going to tell him;"

— a description of the pertinent base-line requirements, including contract provisions and, where necessary, supplemental factual support;

— a description of the increased work, including engineering and technical details as appropriate, plus an explanation of why this work was made necessary by government conduct;

— a legal analysis setting forth the theories and, if necessary, argument in favor of government liability;

— factual support for the amount of dollars claimed to perform the added work, in as much detail as possible (taking into account the context), justifying both the excess labor hours and materials and the pricing of those items;

— a conclusion, "telling the reader what you have told him."

Copyright © 1982 by THE BUREAU OF NATIONAL AFFAIRS, INC., Washington, D.C. 20037
0014-9063/82/$00.50

In each of these sections, the contractor should be concrete and should rely on documentary support — e.g., contract documents, correspondence, reports, photographs, cost records, etc. — to the greatest extent possible. If management controls have been in place, this should be quite feasible.

The Negotiation Process

A *sine qua non* of effective negotiation is that the contractor's own team and key personnel understand the claim in all its aspects. This does not mean that accountants have to be lawyers or that lawyers have to be engineers. But it does mean that the basic thrust of the claim must be understood by all members of the team, so that in the course of negotiations they are all moving in the same direction. It also requires that each team member understand his or her role and not presume to speak in areas where his or her competence may be limited.

The need for a common understanding of each player's role stems from the fact that the negotiation encompasses a number of separate reviews by the government. There may well be an audit. There probably will be a technical review. There undoubtedly will be some form of pricing review, and there certainly will be some form of legal review. Each review may involve different members of the contractor's team, not necessarily including the team leader. Ultimately, there will be informal and formal discussions with the contracting officer that may include some or all of the members of his team.

In each area of expertise, the government representative must be persuaded of the soundness of the claim. The contractor should have as his objective an open and fair discussion, knowing that the earlier he can smoke out a problem, the better will be his chance of dealing with it effectively.

The contractor must avoid putting his own personnel in untenable positions in their separate discussions with their government counterparts, or they will lose their credibility and effectiveness in the negotiation process. On the other hand, contractor personnel must understand that in areas where reasonable judgments may differ, the time and place for making those judgments —including retreating from a prior position where necessary — must be determined by the negotiation team leader, whose sense of timing may be critical to a successful negotiation. In short, the team must have precise marching orders.

Having thoroughly oriented his own personnel, the contractor should now orient each of the government representatives to the basic thrust and merit of the claim. A useful technique is to request that the contracting officer and his team attend a briefing by the contractor, where all aspects of the claim can be presented and reviewed in a manner which transcends engineering technicalities or legalistic formulations. Throughout the entire process, the contractor should make the claim come alive so that its basic equity can shine through the massive detail which the experts will be reviewing. The thoroughness of the contractor's preparation, *per se*, can have a persuasive effect; it will be seen as a reflection of the contractor's sincerity and willingness to "go to the mat" — *i.e.*, litigate. This in turn may obviate the need to do so.

In these presentations the contractor should not put the government on the defensive by assessing blame. That the government is responsible for any increased costs should come through clearly enough from the facts themselves, without making government representatives feel they must defend their own judgment or integrity or point fingers in return at the contractor's personnel. Entitlement to an equitable adjustment does not require that the government have acted in bad faith; such an accusation is difficult to prove and should rarely be made. The ideal outcome is for all involved to agree that the government's action was necessary and contractually permitted, but entitles the contractor to the requested equitable adjustment.

Openness, the repeated demonstration of the contractor's candor, is a critical aspect of the process. It is all too easy for a contracting officer or his staff to say "no." If they are afraid of hidden booby traps, they will do so.

Copyright © 1982 by THE BUREAU OF NATIONAL AFFAIRS, INC., Washington, D.C. 20037

None of this suggests that the contractor should give the government information to which it is not entitled, or fail to protect information whose confidentiality is important. But sooner or later, and certainly in the discovery process which will take place if the claim is litigated, the government is going to obtain any information which it properly needs to assess the claim. Moreover, improperly withholding such information can run afoul of the contractor's certification related to his claim.

Thus from a pragmatic point of view, and because candor encourages a reciprocal response, the contractor should conduct himself in such a way that the government trusts the integrity and completeness of the information it is receiving. When a contractor can make a claim come alive to the government representatives, and when those representatives feel that they are being dealt with openly, the contractor has taken a major step toward negotiating a settlement.

By the time the contracting officer is ready to sit down and negotiate, the contractor, if the members of his team have done their jobs well, will have a fairly good understanding of the positions which the government is likely to take. The contractor nevertheless should request a presentation by the contracting officer and team members of the results of their review. The contracting officer has the same obligations of openness and candor as does the contractor, and is charged with being fair in his duties even though he represents and is an advocate for the government's position. At this point, the contractor's task is to maximize his understanding of the contracting officer's perspective, arguments, and goals. He should listen and inquire, not argue. How the negotiation should proceed from that point will depend on what the contractor learns about how the contracting officer views the claim.

Turning more to the substance of negotiations, it is important to differentiate between those areas where the contracting officer believes he is legally inhibited from allowing an item, and those in which judgment is involved. In the former case, the contractor must demonstrate that the contracting officer is incorrect, or the item will not be allowed. A cost which is not allowable under the regulations or a claim which for some other reason does not have a proper legal basis simply will not fly. If the dollar amounts are sufficient and the circumstances justify it, however, it will be worth the contractor's effort to demonstrate that the invalidity of the claim is not as certain as the contracting officer or his team have suggested. Frivolous elements of a claim, if they exist, should be abandoned, but arguable claims should not be dropped unless doing so contributes to the overall settlement. One has to have real chips to trade, and the more chips one has on the table, the easier the trading process will be.

The contractor should also endeavor to select those areas where he can demonstrate, either factually or legally, that the contracting officer or members of his team are patently wrong. This process serves two purposes: It will correct the context in which the claim will be settled, and it will help the contracting officer recognize that the advice he is getting is not infallible.

Negotiations are often divided between the basic issues of "entitlement" to relief and "quantum," or amount, of that relief. The course of the negotiation depends upon whether the issue of entitlement — i.e., the substantive validity of the claim — has been resolved. Where an explicit change order is involved, the only issue generally will be quantum — i.e., how much is due the contractor. When a constructive change order is involved, on the other hand, the contractor will have to convince the contracting officer at the outset that he is entitled to any recovery at all.

The contractor may find that the contracting officer does not admit the validity of the claim but is prepared to review the estimate of the claim amount. Recognize such a development as possible progress. The contracting officer may be withholding his recognition that a valid claim has been filed to use as a bargaining chip on the issue of amount.

Since the burden of persuasion is on the contractor, there is little point in holding back persuasive documents or arguments for a later day and another forum. The contractor must be prepared to walk the contracting officer through the facts and the law, supported by the best documents available, to establish his legal right to an equitable adjustment.

Copyright © 1982 by THE BUREAU OF NATIONAL AFFAIRS, INC., Washington, D.C. 20037
0014-9063/82/$00.50

The Wall Street adage that "bulls make money, bears make money, and pigs get stuck" is applicable to achieving a settlement. The one approach least likely to succeed is that based upon greed and a lack of realism. The contractor constantly must put himself in the place of the contracting officer and consider what he would do if he were wearing those shoes. He must recognize that there will be disallowances and trade-offs.

It is always useful to understand the negotiating range of the government — what it wants, and what it will accept. On the other hand, negotiation need not be a zero-sum game, where gains to one party can only be made at the expense of the other. Seek areas in which gains are not matched by costs. For example, a time extension for contract performance may greatly benefit the contractor, yet cost the government little.[16]

Setting the agenda is sometimes the most important single step in the negotiation process. The contractor should try to establish the content of the negotiations — and the order — in a way that will maximize the chances of reaching a successful agreement. Breaking a claim into many component parts, rather than treating it on an all-or-nothing basis, will increase the probability that common areas of agreement can be found. Since success feeds on success, it may be helpful to place "easy" items early in the agenda, thereby establishing a pattern of success, cooperation, and trust that may carry forward into more hotly disputed areas.[17]

A tactical sense of when to concede a point or a claim is also important. With each successive "victory" by one party, the other party will feel increasingly pressured to "win" the next battle. A major factor contributing to this pressure on the part of government negotiators (aside from any ego aspect) is the contract clearance requirement, which requires the negotiator to prepare and present for review a prenegotiation outline of objectives and, after negotiations, an explanation of where and why the negotiation results differ therefrom.[18]

Each negotiation has a life cycle of its own. When it is not moving, it may be best to break, regroup, and consider a fresh approach. When movement is perceived, it may be critical to drive forward and carry the process to the end. Sensitivity to timing and momentum is an important qualification of the team leader.

The authority given to the negotiation team leader may be important to this momentum. There are times, for example, when it may be useful for the team leader to say that he must go back and check further with his management, as long as this can be done in a manner which does not suggest weakness of position. But there are other times when it is essential that the team leader be in a position to reach agreement quickly — and the lack of authority to do so may jeopardize the settlement. Realistically, a commitment by the negotiation team leader subject only to management's approval is, except in rare circumstances, the end of the line in the negotiation process. While such form of contingency is not unreasonable as a protection against a settlement that management might reject (since the contracting officer himself has to go up the line for review of what he is prepared to do), there are few people who would take kindly to a negotiation thereafter.

Negotiation Need Not Stop When Litigation Begins

If the contracting officer is advised that a claim is not legally justified, he is unlikely to recommend payment merely because of what might happen in a litigation. However, the inherent risks and costs of litigation are a legitimate consideration in arriving at a level of settlement.

Thus, a contractor seeking a negotiated settlement may be exercising sound judgment by demanding that the contracting officer make a decision, rather than prolonging the negotiating process. That decision will bring the contractor to the next level — where the possibility of a negotiated settlement will be considered from the viewpoint of the litigator.

Under the Contract Disputes Act, a contractor has the choice of taking an appeal from a contracting officer's decision either to the agency's board of contract appeals or directly to the Court of Claims.[19] In either event, a new counsel will be appointed by the government to handle the case. That means there will be a fresh look from a different perspective — the perspective of a litigator.

Copyright © 1982 by THE BUREAU OF NATIONAL AFFAIRS, INC., Washington, D.C. 20037
0014-9063/82/$00.50

Assuming that the claim has merit, though no certainty of outcome, the government's trial counsel may be persuaded that settlement is in the government's best interests. Arguments which failed at an earlier stage may prevail now. Discovery proceedings may demonstrate weaknesses in the government's case and strengths in the contractor's case that previously were not recognized. At this stage a well-prepared litigation file will prove very useful. "Pretrial" proceedings may lead the board or court to suggest that settlement is appropriate, perhaps by merely commenting on some aspect of the case as it is developing. Government attorneys and tribunals have pressures of workload, and speed in resolving a case has its appeal. Moreover, the fact that interest runs if the contractor prevails can be an added economic push for settlement, even apart from the costs of litigation.

Generally, the government's trial counsel cannot settle the matter without the approval of the contracting officer, who may have refused a similar settlement at an earlier date. At this stage, however, the contracting officer will be substantially liberated from prior constraints if he receives a recommendation of settlement from his own trial counsel.

As the case approaches trial, whatever cards have not been shown by either side probably will be turned face up in the discovery process. Thereafter, each party is in the best possible position to evaluate the strengths and weaknesses of each side to the dispute. Again, it is important that realism and not emotion dominate. That the contractor has spent time and money getting to this point does not change the fact that, if a settlement is not reached, he will also incur the added cost and time of the final preparation for trial, trial itself, and subsequent briefing. The costs of the litigation are not productive either to the contractor or the government, and generally will not be reimbursed; they are merely necessary evils if no other method can be found to dispose of the disagreement. Hence, a serious and pragmatic effort at settlement should be made during this period.

A final note. If negotiations succeed, in whole or in part, great care must be taken in memorializing the agreement. Typically, a negotiation memorandum will be prepared by the government, documenting the terms and support for changes in price. This memorandum will form the basis for the government's draft agreement, to be incorporated into the contract in the form of a modification or supplemental agreement. The contractor should be sure that the written agreement includes all items on which agreement was reached and explicitly excludes and reserves all claims or potential claims, including delay and disruption if applicable, that are not intended to be included in the scope of the agreement, or which cannot yet be determined. This latter area is difficult but vital, to avoid subsequent debate over whether claims that are not explicitly excluded — sometimes even claims that are not yet known — are subject to an accord and satisfaction defense. Of course, any explicit language of release or waiver should be carefully and narrowly drafted.

Conclusion

There is no road certain leading to settlement by negotiation. Each negotiation may differ from every other that a contractor has been through because of the type of claim, the amount, the circumstances in whch the claim is presented, or the players on each side of the negotiation process. That one cannot plan the exact course of a negotiation does not diminish the need to plan in advance for a negotiated settlement.

A contractor who, from the start, positions himself to deal effectively with claims — which inevitably will arise — improves his ability to minimize their interference with contract performance and increases his opportunity to have a controlling influence over the negotiation process. Moreover, maintaining a reputation for preparation and credibility in the claims arena increases the likelihood of a contractor's achieving satisfactory negotiated settlements. Each success makes the next a little easier to attain, for the mutual respect that should exist between the contractor and the government is enhanced by a course of dealing in which claims are resolved by agreement rather than litigation.

Copyright © 1982 by THE BUREAU OF NATIONAL AFFAIRS, INC., Washington, D.C. 20037
0014-9063/82/$00.50

Footnotes

[1] Shakespeare, *Henry the Sixth, Part II,* Act IV, Scene II.

[2] Navy Procurement Directives, 32 CFR 737.1-401-55(a), (c).

[3] Army Procurement Procedures, 32 C.F.R. §591.451(c). See also 32 C.F.R. §737.1-452-1 (Navy).

[4] Defense Logistics Agency Contracts Administration Manual, DLAM 8105.1, at 50-600.7a(4).

[5] *Ibid.*, at 50-600.6a(1).

[6] The contractor may be specifically obligated under the contract to inform the contracting officer as soon as possible when he believes that the government has effected a change in the terms and conditions of a contract, to allow the government to mitigate damages. DAR §§7-104.86, 26-800.

[7] *See* DAR §§ 7-604.7 & 7-604.8, which require network analysis systems.

[8] Program Evaluation Review Technique.

[9] *See* Wickwire and Smith, "The Use of Critical Path Method Techniques in Contract Claims," 7 *Pub. Cont. Lw J.* 1 (1974), and sources cited therein.

[10] *See* C. H. Leavell & Co., GSBCA No. 2901; *But cf.* Fondahl, "Can Contractors' Own Personnel Apply CPM Without Computers," *The Constructor* (November and December 1961).

[11] DAR 7-104.90.

[12] *Cf.* DAR §§7-602.36, 26-101(b).

[13] DAR §7-104.89.

[14] DAR §7-104.86.

[15] *See, e.g.*, Navy Procurement Directive, 32 C.F.R. §737.1-401-55(c)(2)(iii).

[16] A good discussion of the game theoretical aspects of negotiation can be found in T. Schelling, *The Strategy of Conflict* (1966).

[17] A helpful discussion of the theory of negotiation may be found in Karrass, *The Negotiating Game* (1970).

[18] DAR §3-811; FPR §1-3.811(a)(7); 32 C.F.R. §737.1-403-51(b)(2)(iii)(Navy).

[19] 41 U.S.C. §§606, 609(a)(1).

-- End of Section K --

Copyright © 1982 by THE BUREAU OF NATIONAL AFFAIRS, INC., Washington, D.C. 20037
0014-9063/82/$00 50

CLAIMS AND DISPUTES

by

Robert J. Wehrle-Einhorn
Professor of Contract Law and Management

The disputes procedure in effect today was established by the Contract Disputes Act of 1978 (41 USC Section 601 et seq.). That Act defined the responsibilities of the parties at each step of the procedure, beginning with the initial action of the contractor in filing the claim with the contracting officer. A brief historical review may be helpful in maintaining an appropriate perspective.

Since American law grew out of English common law, the doctrine of "sovereign immunity" has a long history in the United States. That doctrine was originally based on the concept that the king of England, who ruled by divine right, could do no wrong. As a result, the courts would not allow a lawsuit against the king. The English settlers brought the concept of sovereign immunity with them to the American colony, and it became ingrained in American law as well.

As a result, Government contractors in America were unable to sue the Government for such items as non-payment or other breaches of contract until 1855, when Congress first provided by statute that the Government could be sued on contract matters. This statute later became known as the Tucker Act, and it is still called that today (28 U.S.C. Section 1491 et seq.). It was not until 1946 that Congress substantially expanded its waiver of sovereign immunity by passage of the Tort Claims Act, which allowed law suits against the government concerning many types of non-contractual injuries.

Since the Government has sovereign immunity unless it chooses to waive that immunity, the Government can specify and limit the conditions under which the waiver of immunity will be effective. For example, Congress can specify the forum where matters will be litigated, what types of matters can be litigated, and so on. That is what Congress has done in the Contract Disputes Act.

THE CONTRACTING OFFICER LEVEL

Under the Act, a contractor initiates a claim by reducing it to writing and submitting it to the contracting officer for a decision. The Act does not define the term "claim," but the Federal Acquisition Regulation (FAR) does at Section 52.233-1; that section requires insertion of the following language at paragraph (c) of the Disputes clause:

> "Claim," as used in this clause, means a written demand or written assertion by one of the contracting parties seeking, as a matter of right, the payment of money in a sum certain, the adjustment or interpretation of contract terms, or other relief arising under or relating to this contract. [Emphasis added] A claim arising under a contract, unlike a claim relating to that contract, is a claim that can be resolved under a contract clause that provides for the relief sought by the claimant. However, a written demand or written assertion by the contractor seeking the payment of money exceeding $50,000 is not a claim under the Act until certified as required by subparagraph (d)(2) ... . [Emphasis added] A voucher, invoice or other routine request for payment that is not in dispute when submitted is not a claim under the Act. The submission may be converted to a claim under the Act, by complying with the submission and certification requirements of this clause, if it is disputed either as to liability or amount or is not acted upon in a reasonable time.

Thus a "claim" is a demand for a specific amount of money or other relief to which a contracting party asserts a right.

The statement in the clause that a contractor's demand for more than $50,000 is not a claim until it is "certified" is a reference to Section 605(c)(1) of the Contract Disputes Act, which says that:

> For claims of more than $50,000, the contractor shall certify [1] that the claim is made in good faith, and [2] that the supporting data are accurate and complete to the best of his knowledge and belief, and [3] that the amount requested accurately reflects the contract adjustment for which the contractor believes the government is liable.

Although the contractor need only recite the substance of this certification, as a general practice contractors use these exact words in order to avoid any question as to whether the certification will be effective. Failure to certify as to each of the three elements can render the certification ineffective. For

example, failure to certify that the claim is made in good faith has been held to render the certification ineffective, although the courts and Boards of Contract Appeals will review the text of the certification and claim to see if the missing element of the certification can reasonably be implied.

In addition, a contractor may attempt to submit a limited or qualified certification. For example, the contractor might certify that the supporting data are accurate and complete, "subject to further analysis." Such a qualification has been held to prevent the certification from being effective because the statute does not allow for a lesser certification than is specified in Section 605(c)(1), above.

Occasionally a question arises concerning whether the $50,000 threshold for certification allows segmentation of the components of a claim, or requires aggregation of all matters related to the same contract. In general, for purposes of applying the $50,000 threshold the contractor is required to aggregate all items having "a common nucleus of operative facts."

What if the amount of the claim increases after the claim has been submitted? If the claim was previously certified, the prevailing view is that no new certification is needed, as long as the factual basis for the claim has not changed substantially. However, where an uncertified claim subsequently increases to more than $50,000 before the contracting officer issues a final decision, the contractor's failure to certify may prevent an appeal if the contracting officer denies the claim, particularly if the contractor had had reason to know that the claim would increase and exceed $50,000.

Why does it matter whether a claim has the appropriate certification? Until a contractor's claim for more than $50,000 has been certified, the contracting officer is not authorized by the Contract Disputes Act to consider it. The Act mandates at Section 605(c)(1) that the contracting officer issue a decision "on any submitted claim of $50,000 or less within sixty days from his receipt of a written request from the contractor that a decision be rendered within that period." In contrast, Section 605(c)(2) provides that where the amount in dispute exceeds $50,000 the contracting officer shall take certain action "within sixty days of receipt of a submitted certified claim." [Emphasis added] Thus where the amount in dispute exceeds $50,000, the absence of the statutory certification prevents the contracting officer's duty to render a decision from arising.

Further, the contractor's failure to comply with the certification requirement may affect the contractor's right to receive interest with respect to its claim. The Contract Disputes Act expressly provides at Section 611 for the contractor to receive interest which accrues "from the date the contracting

officer receives the claim pursuant to Section [605(a)] from the contractor until payment thereof." If the purported claim lacks a necessary certification and is therefore not a claim for purposes of Section 605, then interest would presumably not begin to accrue until proper certification is made.

As previously mentioned, when the claim involves up to $50,000 the contracting officer has a duty to issue a written decision within 60 days. If the amount exceeds $50,000 the contracting officer has 60 days to either issue a decision or notify the contractor of the (reasonable) time within which a decision will be issued.

If the contracting officer fails to issue a decision within the specified time, the contractor has two remedies available. First, the contractor may ask the agency Board of Contract Appeals to direct the contracting officer to issue a decision within a specified period of time. Alternatively, the contractor may ask the Board to treat the contracting officer's failure to issue a decision as if the contracting officer had denied the claim, and to hear the contractor's appeal. However, the Board retains discretion to suspend any action on such an appeal and to require the contracting officer to issue a decision. These procedures are set out in Section 605 (c)of the Act.

In order for the contracting officer's decision to be effective it must be in writing, and it must be furnished to the contractor by mail or some other means of delivery. The Contract Disputes Act requires that the decision state the contracting officer's reasons, but the decision need not contain specific findings of fact; if it does contain specific findings of fact, then in the event the contractor appeals from the contracting officer's decision, those findings are not binding on either the contractor or the government. In fact, the Armed Services Board of Contract Appeals has, in at least one instance, reduced the amount of equitable adjustment made by the contracting officer; in Assurance Co., ASBCA No. 30116 (86-1 BCA Para. 18,737), January 28, 1986, the Board made its own factual finding as to the proof submitted by the contractor, and reduced the contracting officer's award.

The contracting officer's decision is required by Section 605(a) to inform the contractor of his rights under the Contract Disputes Act, and of the procedure to follow in the event the contractor elects to appeal from the decision. Once the contractor receives the contracting officer's decision, the time for appeal from that decision begins to run.

APPEAL FROM THE CONTRACTING OFFICER'S DECISION

Historically, a contractor has been required to exhaust the available administrative remedies before a court would exercise

its jurisdiction to hear the case. Before enactment of the Contract Disputes Act of 1978, for example, a contractor raising a dispute concerning a matter "arising under the contract" would usually be required to have its hearing before the appropriate board of contract appeals before the Court of Claims would hear the matter. Once the board had spoken, the Court of Claims could then hear an appeal from the Board's decision.

However, if there was no potential administrative remedy available, the contractor was able to appeal from the contracting officer's decision directly to the Court of Claims. For example, if the dispute concerned an alleged breach of contract, the board would not have authority to decide the case because such an allegation would not involve a dispute "arising under the contract." Consequently, there would be no available administrative remedy to be exhausted before the Court of Claims would hear the matter, and the matter could proceed to court.

The Contract Disputes Act of 1978 eliminated the need for contractors to pursue remedies through the boards of contract appeals before appealing to the Court of Claims. Among other things, it was intended to ensure that contractors would have access to an independent forum.

Board of Contract Appeals

Prior to enactment of the Contract Disputes Act, the Disputes clause in government contracts specified that decisions of the contracting officer were subject to review by the representative of the agency head, whose decision was to be final; in general, the board of contract appeals was the representative of the agency head for that purpose, and the source of their authority was the Disputes clause itself.

Under the Contract Disputes Act, the jurisdiction of the boards became statutory, although the agency head may still elect whether to appoint a board or refer appeals to the board of another agency. Section 607(d) of the Act declares that the board has jurisdiction to decide

> any appeal from a decision of a contracting officer ... relating to a contract made by its agency... . In exercising this jurisdiction, the agency board is authorized to grant any relief that would be available to a litigant asserting a contract claim in the Claims Court [formerly part of the Court of Claims, as explained below].

Usually a single Administrative Judge conducts the trial and writes a decision for review by a panel of several other judges. The reasons for this arrangement are to provide for expeditious

disposition of cases, while at the same time providing consistent and uniform decisions of high quality. When the panel adopts the decision (it need not be unanimous), the decision is officially issued.

The Armed Services Board of Contract Appeals has 33 members, including a chairman and two vice-chairmen. It is divided into ten divisions, each of which has five members: the chairman, one vice-chairman, and three other board members (one of whom is the division head). In general, a decision supported by a majority of a division will be the board's decision; however, the chairman may refer a matter to the board's Senior Deciding Group, a body composed of the chairman, the two vice-chairmen, and the ten division heads. That body deals with the unusually difficult cases, as well as cases which are likely to have important value as precedents or which involve matters of serious disagreement among divisions.

According to Section 606 of the Contract Disputes Act, a contractor may appeal to a board from a contracting officer's adverse decision "[w]ithin ninety days from the date of receipt of" the contracting officer's decision. The contractor has the burden of proving (usually by post mark, affidavit or postal meter setting) that the appeal was filed on time. Mailing the appeal on the 90th day is considered to meet the deadline, but hand-delivery on the 91st day is not.

Before passage of the Act, the standard time for appeals from contracting officers' decisions was 30 days, and that time limitation was written into the Disputes clause. Although the Act allows a greater amount of time for the contractor to appeal, there can be no extension of time. The statutory 90-day period has been held to be jurisdictional, which means that boards have no authority to hear a case unless the filing deadline is met. Thus the boards cannot waive the 90-day filing requirement, even though the earlier 30-day filing requirement could be waived for good cause shown.

However, it should be noted that if the contract on which the claim is based was entered before March 1, 1979 (the effective date of the Contract Disputes Act), the contractor may elect to have its disputes decided in accordance with the Disputes clause of the contract rather than the statutory procedure established by the Act. It is a matter for the contractor to determine whether to elect to proceed "under the contract" or "under the statute," and the contractor cannot later reverse the election.

When a contractor elects to appeal to the ASBCA from a contracting officer's decision, the contractor is required to mail or otherwise deliver a written notice of appeal to the board within 90 days. In addition, the contractor must furnish a copy to the contracting officer, who has 30 days to assemble and transmit to the board a "Rule 4 file"; "Rule 4" refers to one of the Rules of Practice of the ASBCA. Other agency boards of

contract appeals have their own versions of Rule 4, which are usually very similar.

The Rule 4 file includes (a) a copy of the decision from which the appeal is being taken; (b) the contract, including pertinent specifications, amendments, plans, and drawings; (c) all correspondence between the parties relevant to the appeal, including the written claims in response to which the contracting officer's decision was issued; (d) affidavits or other statements made by witnesses before the appeal was filed, and transcripts of any testimony taken in the proceedings; and (e) any additional information considered relevant to the appeal. The documents included in the file are to be either the originals or legible facsimiles or authenticated copies; they are required to be arranged in chronological order where practicable, numbered sequentially, tabbed, and indexed to identify the contents of the file.

The contracting officer is also required to provide a copy of this file, except for a copy of the contract (including amendments and attachments as described in (b) above), to the contractor within 30 days after receiving notice of the appeal. The contractor then has 30 days from receipt of the file to submit to the board any additional documents which the contractor considers relevant, and to provide two copies to the government trial attorney.

Section 607(e) of the Act directs that to the fullest extent practicable, the board shall provide "informal, expeditious, and inexpensive resolution of disputes." In order to accomplish these objectives, the boards of contract appeals will conduct trials at locations which are convenient for the parties, rather than require the parties to travel to Washington, D.C. for each trial.

Rule 17 of the Armed Services Board of Contract Appeals (ASBCA), for example, states that it will hold hearings "at such places determined by the Board to best serve the interests of the parties and the Board." In addition, hearings before the boards tend to be less formal than comparable judicial proceedings. Although litigation before a board can in some cases require extended periods of time (i.e., years), the Contract Disputes Act also provides for certain special procedures which the contractor may invoke if the amount of money in dispute is relatively small.

Section 607(f) of the Act requires that the board provide a procedure for the "accelerated disposition" of claims in amounts up to $50,000. This accelerated procedure, which may be elected by the contractor without regard to the government's preference, means that the board is required to resolve the matter if possible within 180 days after the contractor invokes the procedure.

The Act does not expressly provide for any deviations from the Board's standard procedure in order to meet this 180-day

"deadline." Although it might be possible for the Board to issue decisions within that time frame by merely giving priority to cases involving $50,000 or less, the ASBCA has tailored some of its Rules of Practice to fit the situation. In Rule 12.3(a), for example, the Board states that when accelerated disposition is invoked by the contractor,

> ...the parties are encouraged, to the extent possible consistent with adequate presentation of their factual and legal positions, to waive pleadings, discovery, and briefs. The Board, in its discretion, may shorten time periods prescribed or allowed elsewhere in these Rules, including Rule 4, as necessary to enable the Board to decide the appeal within 180 days after the Board had received the appellant's notice of election of the ACCELERATED [sic] procedure, and may reserve 30 days for preparation of the decision.

In addition, Rule 12.3(b) calls for a somewhat different mechanism for the issuance of decisions rendered pursuant to the accelerated procedure:

> Written decisions by the Board in cases processed under the ACCELERATED procedure will normally be short and contain only summary findings of fact and conclusions. Decisions will be rendered for the Board by a single administrative judge with the concurrence of a vice chairman, or by a majority among these two and the chairman in case of disagreement. Alternatively, in cases where the amount in dispute is $10,000 or less as to which the ACCELERATED procedure has been elected and in which there has been a hearing, the single administrative judge presiding at the hearing may, with the concurrence of both parties, at the conclusion of the hearing and after entertaining such oral arguments as deemed appropriate, render on the record oral summary findings of fact, conclusions, and a decision of the appeal. Whenever such an oral decision is rendered, the Board will subsequently furnish the parties a typed copy of such oral decision for record and payment purposes, and to establish the starting date for the period for filing a motion for reconsideration under Rule 29.

(Rule 29 allows 30 days, counted from the date when the party receives a copy of the Board's decision, for requesting reconsideration of the Board decision.)

In addition to the procedure for "accelerated disposition," each board is required by the Contract Disputes Act to provide a small claims procedure for the "expedited disposition" of claims in amounts up to $10,000. (The Act provides for increases in the $10,000 threshold from time to time.) This procedure is available to the contractor without regard to the government's preference.

The board is required by the Act to resolve cases under the small claims procedure within 120 days if possible after the contractor invokes the procedure. In view of this time frame, the board is expressly authorized by the Act to follow simplified rules of procedure in order to render a prompt decision. Since the parties may not have the opportunity to develop their arguments as fully as they would under the normal procedure, the Act says that board decisions made under the small claims procedure are given no value as precedents, and the board decision will not be set aside unless shown to be fraudulent.

The ASBCA has established special rules for its small claims procedure, in order to meet the 120-day deadline for decisions. First, once the Government receives a copy of the contractor's notice that it is invoking the small claims procedure, the Government has only 10 days to send to the Board a copy of the contract, the final decision issued by the contracting officer, and letter or letters in which the contractor made the claim which is the subject of the dispute. (Other documents are submitted pursuant to Rule 4, as discussed below.)

In addition, the Board's Rule 12.2(a)(2) imposes certain duties on the administrative judge in order to move the proceedings quickly:

> Within 15 days after the Board has acknowledged receipt of appellant's notice of election [of the small claims or expedited procedure], the assigned administrative judge shall take the following administrative actions, if feasible, in an informal meeting or a telephone conference with both parties: (i) identify and simplify the issues; (ii) establish a simplified procedure appropriate to the particular appeal involved; (iii) determine whether either party wants a hearing, and if so, fix a time and place therefore; (iv) require the Government to furnish all the additional documents relevant to the appeal; and (v) establish an expedited schedule for resolution of the appeal.

Further, the administrative judge is directed by Rule 12.2(b) to avoid delays to the extent possible:

> Pleadings, discovery, and other prehearing activity will be allowed only as consistent with the requirement to conduct the hearing on the date scheduled, or if no hearing is scheduled, to close the record on a date that will allow decisions within the 120-day limit. The Board, in its discretion, may impose shortened time periods for any actions prescribed or allowed under these rules, as necessary to enable the Board to decide the appeal within the 120-day limit, allowing whatever time, up to 30 days, that the Board considers necessary for the preparation of the decision after closing the record and the filing of briefs, if any.

As in the case of the accelerated procedure, the written decision of the administrative judge in a small claims case will "be short and contain only summary findings of fact and conclusions." Only a single administrative judge is involved, and the judge may render the decision orally (with a typed copy to be provided to the parties).

Even where the small claims procedure or the accelerated procedure is not applied, the Board is still required to provide expeditious, informal and inexpensive resolution of disputes. However, the Act is generally thought to have "judicialized" board appeals. Section 610 of the Act gives Administrative Judges the power to compel testimony and the production of documents. Further, the Act specifically authorizes depositions and the enforcement of subpoenas issued by the Boards, upon application by the U.S. Attorney General (i.e., the Department of Justice) in a federal district court. Failure to comply with a court order enforcing a subpoena may be treated as contempt of court.

Thus in many ways a proceeding before a board is very similar to a court trial. Apart from the "small claims" and "accelerated disposition" options which the board makes available to the contractor, the main features of interest in board proceedings are the informality and the board's willingness to conduct hearings at convenient locations. In addition, a contractor who is considering whether and how to appeal from a contracting officer's decision would want to be aware of a study by the General Accounting Office: GAO found that although the Armed Services Board of Contract Appeals is not organizationally independent, it is perceived by members of the contracting community as being independent of the Department of Defense in its decision making processes.

These are important considerations to the contractor, who must make the election whether to appeal from the contracting officer's decision to the agency board or to the Claims Court. It has been held that once the election is made, it is irreversible because the forum not chosen by the contractor lacks jurisdiction to hear the case later. Consequently, if the forum selected dismisses the appeal or renders an unfavorable decision, or if the contractor has a change of heart, the contractor cannot then pursue the matter in the other forum.

Claims Court

Historically, the Court of Claims was the main forum designated by Congress to hear or review disputes related to express or implied government contracts. Until 1978 the federal district courts, which are the federal trial courts of general jurisdiction, also had jurisdiction to hear or review disputes related to government contracts, but only where the amount of money in dispute did not exceed $10,000.

The Contract Disputes Act of 1978 eliminated most of this overlap of jurisdiction by removing the statutory authority of the federal district courts to decide matters related to most government contract disputes. (The federal district courts continue to have a role in reviewing government action in awarding government contracts, but not in matters related to the performance of most government contracts.)

The Act also eliminated the general requirement that a contractor exhaust the available administrative remedies before seeking judicial relief. It expressly provided at Section 609 that:

> [I]n lieu of appealing the decision of the contracting officer under [sec. 605] to an agency board, a contractor may bring an action directly on the claim in the United States Court of Claims, notwithstanding any contract provision, regulation or rule of law to the contrary. ... Any action ... shall be filed within twelve months from the date of the receipt by the contractor of the decision of the contracting officer concerning the claim, and shall proceed de novo in accordance with the rules of the appropriate court.

Under the Contract Disputes Act the Court of Claims had two functions: it had both "original" jurisdiction (i.e., it could conduct trials, hear the testimony of witnesses, etc.) and appellate jurisdiction (i.e., it could consider appeals from other forums, such as boards of contract appeals). The Court of Claims also had two divisions, one for trials (the Trial Division) and one for appeals (the Appellate Division).

In 1982, the Federal Courts Improvement Act transformed the Trial Division of the Court of Claims into the U.S. Claims Court. The Court of Claims trial judges on October 1, 1982 became judges on the Claims Court. Their terms of office expired on October 1, 1986 or 15 years after the date of their appointment to the Court of Claims, whichever came first.

In this reorganization the trial judges were given some additional power. As trial commissioners of the Court of Claims, they had had authority to issue only "recommended decisions" to the appellate judges. In contrast, as judges of the Claims Court they received authority to "enter dispositive judgments."

There are 16 Claims Court judges, appointed by the President for terms of 15 years. They are not organized in the same manner as

the Administrative Judges of the ASBCA. Cases brought before the Claims Court are heard by a single judge, whose opinion need not be reviewed or approved by anyone before issuance. Consequently, the judges are not obligated to defer to each other's opinions or to follow each other's prior decisions. Conflicts between decisions of individual Claims Court judges are resolved by the Court of Appeals for the Federal Circuit, discussed infra.

Although the Claims Court sits in Washington, D.C., it may in appropriate circumstances conduct trials elsewhere for the convenience of the parties. However, the Claims Court does not have the same statutory mandate as the boards to provide informal, expeditious and inexpensive resolutions of disputes. Consequently, in general, a Claims Court trial is likely to be more formal in nature than a board trial. This formality and the expense it entails may be important considerations for the contractor in deciding whether to appeal from the contracting officer's adverse decision to the board or to the Claims Court.

Court of Appeals for the Federal Circuit

The Federal Courts Improvement Act of 1982 created the Court of Appeals for the Federal Circuit. That Court includes the former appellate division of the Court of Claims and the Court of Customs and Patent Appeals. Among other things it hears appeals from decisions of both the Claims Court and the boards of contract appeals.

The Contract Disputes Act, as amended by the Federal Courts Improvement Act, expressly provides at Section 607(g)(1) for review of board decisions by the Court of Appeals for the Federal Circuit:

> The decision of an agency board of contract appeals shall be final, except that --
> (A) a contractor may appeal such a decision to the United States Court of Appeals for the Federal Circuit within one hundred twenty days after the date of receipt of a copy of such decision, or
> (B) the agency head, if he determines that an appeal should be taken, and with the prior approval of the Attorney General, transmits the decision of the board of contract appeals to the United States Court of Appeals for the Federal Circuit for judicial review, under [Section] 1295 of title 28, United States Code, as amended herein, within one hundred twenty days from the date of the agency's receipt of a copy of the board's decision.

Thus the government as well as the contractor has the opportunity to appeal from an adverse board decision, and each party has 120 days to file the appeal. It should be noted that the Court of Appeals for the Federal Circuit has exclusive jurisdiction over such appeals; there is no other forum to hear appeals from board decisions.

It should also be noted that the government's decision whether to appeal is not made by the contracting officer. The government did not have authority to appeal from board decisions prior to 1978, when the Contract Disputes Act expressly authorized such appeals. In fact, the question whether the government should be able to appeal from board decisions was one of the major issues resolved by the Act.

In the case of S & E Contractors v. U.S., 406 U.S. 1 (1972), the Supreme Court held that under the current Disputes clause the government could not appeal from an adverse board decision. This policy was reversed by Congress six years later, after much debate, in the Contract Disputes Act. However, it was contemplated that the government should not appeal from such decisions casually or routinely; thus the statute required that the decision whether to appeal be elevated to the agency head, with the prior approval of the attorney general.

The Act also established the standards that must be met by a party seeking to overturn a board decision. Section 609 (b) expressly provides that whether the appellant is the contractor or the government,

> [T]he decision of the agency board on any question of law shall not be final or conclusive, but the decision on any question of fact shall be final and conclusive and shall not be set aside unless the decision is fraudulent, or arbitrary, or capricious, or so grossly erroneous as to necessarily imply bad faith, or if such decision is not supported by substantial evidence.

These five grounds for overturning a board decision were first adopted by Congress in the Administrative Disputes Act of 1954. That Act is also called the Wunderlich Act or the Anti-Wunderlich Act, and these Wunderlich standards have continued in effect without change since that time. Now that the government can appeal board decisions, the government must meet those same standards in order to have a board decision reversed on appeal.

The standard for reversing a decision by the Claims Court is somewhat different. The Federal Rules of Civil Procedure provide at section 52(a) that findings of fact by the Claims Court will be set aside only if they are found to be "clearly erroneous." The Court of Appeals for the Federal Circuit has not yet had occasion to decide whether this standard is a higher standard than that which must be met in order to overturn a board decision (i.e., "not supported by substantial evidence").

It appears possible that a decision could be "supported by substantial evidence" and still be "clearly erroneous"; thus, the difference in standards suggests that board decisions might be accorded greater deference, and that it might be easier to have the same decision set aside if it were issued by the Claims Court than if it were issued by a board of contract appeals. This is an interesting but fairly subtle point for attorneys to ponder. Of greater importance to the contractor, however, is whether the track record of the board or the Claims Court suggests greater receptivity to the contractor's claim, and without unduly burdensome cost and effort.

RELATED MATTERS

Public Law 85-804

Pub. L. 85-804 was enacted on August 28, 1958. It preserved a special set of remedies available to Government contractors which otherwise would have expired then. President Eisenhower implemented the statute, which was codified at 29 U.S.C. Sec. 1431, by issuing Executive Order No. 10789. Subject to certain limitations, the statute provides that:

> The President may authorize any department or agency of the Government which exercises functions in connection with the national defense ... to enter into contracts or into amendments or modifications of contracts heretofore or hereafter made and to make advance payments thereon, without regard to other provisions of law relating to the making, performance, amendment, or modification of contracts, whenever he deems that such action would facilitate the national defense. [Emphasis supplied]

Executive Order No. 10789 delegates authority to the Secretary of Defense and the service secretaries; it also makes similar delegations to the secretaries of various other departments and the heads of various specific agencies.

Pursuant to Public Law 85-804, also called the Contract Adjustment Act, each authorized department or agency has provided a form of Contract Adjustment Board. As noted above, the Boards make adjustments to contracts "without regard to other provisions of law," which means they have extraordinary authority.

Three types of cases have generally been referred to the Contract Adjustment Boards, in each instance involving a situation beyond the capability of the contracting officer and the usual dispute resolution mechanism to resolve. The FAR addresses these types of cases at Section 50.302.

One type involves a need for a contract amendment or modification without consideration. The common law requires that there be an exchange of consideration as an essential element in every contract, and in every contract amendment as well. A contracting officer generally lacks authority to pay a contractor more money than was originally agreed, for example, unless there is a change in the consideration which the Government will receive.

However, the Contract Adjustment Boards do have the authority to make such an adjustment, if necessary to protect the productive capability of a contractor whose continued operation is essential to the national defense.

The Contract Adjustment Boards also have authority to reform contracts to correct for a mutual mistake between the contractor and the Government, or a contractor's mistake that should have been apparent to the contracting officer. Prior to 1978 only these Boards had the authority to reform or rescind contracts in such situations, but that was changed by the Contract Disputes Act. The Act by its terms provided for its dispute resolution procedure to apply to all claims "related to" (rather than "arising under") the contract.

Complex legal issues may arise in connection with a contractor's claim of entitlement to reformation or rescission of a contract. See, for example, the brief discussion at Section 33.005 of the FAR. Only if the contracting officer lacks authority to grant the reformation or rescission does the Contract Adjustment Board have authority to consider the matter. Thus it is incumbent on the contractor to submit its claim for reformation or rescission first to the contracting officer for consideration.

The third type of case where the Contract Adjustment Boards have become involved involves the formalization of informal commitments, under certain unusual circumstances. The purpose of this action is to permit payment to a contractor who has relied in good faith on the representations of Government agents and the "apparent authority" of those agents to make those representations. Although the government is not bound by the doctrine of "apparent authority," it may be important on occasion to facilitate the national defense by reassuring such contractors that they will be treated fairly.

It should be remembered that the relief offered by Pub. L. 85-804 is not available to contractors as an entitlement. The contractor does <u>not</u> have a <u>right</u> to such the types of adjustments described above; the adjustment is for the benefit of the government, and any benefit the contractor receives is a matter of grace rather

than entitlement. In general, the contractor will seek and need the endorsement of the contracting officer for its request for relief. It is then for the contracting officer to make the initial determination of what result would be in the national interest.

Equal Access to Justice Act

This chapter began with a brief discussion of sovereign immunity as the background against which contractors historically struggled to assert contract rights against the Government. Once Congress had adjusted the disputes procedure in the Contract Disputes Act of 1978, placing the parties on a more or less equal footing in terms of their procedural rights with respect to contract disputes, the major remaining imbalance between the parties was related to the cost of litigation.

Small contractors were in some instances unable to bear the cost of litigation, and thus might be unable to assert their rights even where there was substantial merit to their claim. Beginning in October 1981, however, the Equal Access to Justice Act, 5 U.S.C. Section 504, provided that a small party prevailing against a Government agency in an "adversary adjudication" could recover its "fees and other expenses."

The Act itself defined "fees and other expenses" to include reasonable expenses for expert witnesses; reasonable expenses for engineering reports, studies, tests, analyses, etc.; and "reasonable attorney or agent fees." The definition of parties eligible to receive this benefit includes a corporation or other business association whose net worth did not exceed $7 million and which did not employ more than 500 employees as of the time the "adversary adjudication" was begun.

There is, however, a major obstacle to a contractor's recovery of such fees and expenses under the Act, even where the contractor wins a lawsuit. In order to recover, it is not sufficient that the contractor prevails in the litigation; the contractor must also show that the Government's position was not "substantially justified."

Consequently, a small contractor may prevail in litigation against the Government and still not recover its fees and costs, if the Government's position, even though wrong, was substantially justified under the circumstances. One example would be a situation where the Government was litigating a complicated issue for the first time, where it was not clear

whether the Government's position would be sustained. On the other hand, the courts have held that the contractor need not actually win a lawsuit in order to qualify for recovery of its fees and expenses; the contractor can be found to "prevail" and thereby to qualify for recovery of its expenses if the settlement agreement substantially indicates that the contractor's claim is meritorious and that the government's position was not substantially justified.

Soon after enactment of the Equal Access to Justice Act a question arose as to whether it gave Boards of Contract Appeals authority to award fees and expenses, or whether only courts had that authority. The issue was resolved by Congress, which amended the Act to specify that Boards as well as courts can make such awards.

Government Claims

The Contract Disputes Act of 1978 states at 10 U.S.C. Section 605(a) that the Government is required to assert its claims against a contractor by means of a contracting officer's decision:

> All claims by the Government against a contractor relating to a contract shall be the subject of a decision by the contracting officer.

This occasionally causes some confusion as to when a claim is being made and who is making the claim. Where the Government disallows a contractor's costs after the contractor has been paid, for example, the contractor may appeal the disallowance. In one such case in 1986, the Government asked the ASBCA to dismiss the case on the grounds that the contractor had failed to certify the claim. The Board denied the Government's motion; since the contractor had already been paid, it was not the contractor but the Government who was making the claim in this instance.

More recently a dispute arose concerning whether a contractor was responsible for laying carpet in a building rented by the Government from the contractor. The contracting officer sent the contractor a letter purporting to be a final decision, placing responsibility for laying the carpet on the contractor; however, the contractor had not submitted a claim. Instead of appealing, the contractor later determined an estimated cost of doing the work and submitted a certified claim to the contracting officer. Four months after that submission the contractor appealed from the contracting officer's failure to issue a decision.

The Government's position was that the contractor's appeal was untimely, in that the contractor should have appealed from the contracting officer's final decision several months earlier. The General Services Board of Contract Appeals (GSBCA) rejected that argument, holding that the contracting officer's letter was not a "final decision" from which an appeal could be taken; it was merely a declaration of rights and obligations under the contract.

Whether a claim belongs to the Government or to a contractor, the Board added, depends on who has the burden of proof. Here the issue was whether the Government's ordering the contractor to lay the carpet was a constructive change which would entitle the contractor to an equitable adjustment; since the burden of proof on that issue is the contractor's, the claim belonged to the contractor rather than the Government. Thus in the absence of a claim by the contractor, there could be no "final decision" by the contracting officer and there was no need to appeal from the contracting officer's letter.

Government Reactions

Most disputes are raised in good faith. They usually reflect honest disagreements concerning the parties' obligations under the contract, and often can be traced to misunderstandings and failed communication. In general, then, the contracting officer needs to be patient and willing to hear and understand the contractor's point of view. Yet if the government has reason to believe that a contractor's claim is not made in good faith, it has a powerful array of weapons at its disposal.

Historically, a key statutory remedy available to the government where a contractor submitted false claims was provided by the False Claims Act. It was enacted during the Civil War in response to war profiteering at the government's expense.

The False Claims Act has two components, the civil false claims act (31 U.S.C. Section 3729 et seq.) and the criminal false claims act (18 U.S.C. Section 287). Under the latter, a person submitting a claim known to be false is subject to a fine and imprisonment for up to 5 years. It is a criminal statute, requiring that the government prove its case beyond a reasonable doubt. Until recently the maximum fine was $10,000 per claim, which was not necessarily much of a deterrent. However, the Department of Defense Authorization Act for Fiscal Year 1986

raised the maximum fine to $1,000,000 per claim submitted to the Department of Defense.

Similarly, the potential liability of a contractor under the civil false claims act has been increased recently, although not as dramatically as the criminal statute. For false claims submitted to the Department of Defense, the amounts for which the contractor is potentially liable include three times the amount of the false claim paid by the government, plus a civil penalty of $2,000 per claim, plus the government's cost of the action to recover those amounts.

Although the amount of potential civil liability of the contractor has not increased as dramatically as the potential criminal liability, there has been a significant change in the government's ability to win civil false claim cases. What has changed is the nature of the contractor's action necessary to make him liable for civil penalties.

Prior to the False Claims Act Amendments of 1986 the civil false claims act imposed liability where a person "knowingly" submitted a false claim for approval or payment or took certain other actions. The original Act did not define the term "knowingly," and it was interpreted as having the ordinary meaning of that word: acting with knowledge that the claim was false.

The amendment inserted in the statute a new definition ofthe term "knowingly." For purposes of applying the civil false claims act, it now means: (1) that the person has actual knowledge that the claim is false; or (2) that the person is acting in deliberate ignorance of the truth or falsity of the information; or (3) that the person acts in willful disregard of whether the information is true or false.

Under the earlier interpretation, a contractor who was inclined to be deceitful could maintain a protective facade of ignorance. Under the new definition, a contractor who deliberately avoids knowledge in order to be able to claim ignorance may be held liable nonetheless.

Somewhat allied to the False Claims Act is the False Statements Act, 18 U.S.C. Section 1001, another criminal statute. It provides that a person who "knowingly and willfully falsifies, conceals or covers up ... a material fact" in any matter within the jurisdiction of any Government agency is subject to a maximum fine of $10,000 and imprisonment for up to five years.

Two other remedies have recently been added to the Government's arsenal. First, the Program Fraud Civil Remedies Act of 1986 (31 U.S.C. Section 3801 et seq.) established a new administrative procedure for dealing with false claims involving amounts of up to $150,000. Although the administrative determination of liability is subject to judicial review, it can be overturned only upon a showing that the determination was not supported by

substantial evidence on the basis of the record as a whole. A contractor found liable under this statute would be liable for twice the amount of the false claim plus a civil penalty of $5,000.

The other remedy added recently to the Government's arsenal is an amendment to the Truth in Negotiations Act (10 U.S.C. Section 2306a). The Act now provides at subsection 2306a(e)(1)(B) that if a contractor's submission of defective cost or pricing data was "a knowing submission," then the contractor would be liable for "an additional amount equal to the amount of the overpayment." Thus the contractor would be liable for twice the amount of overcharge resulting from the knowing submission of defective cost or pricing data.

The Office of the Department of Defense Inspector General has expressed the view that these various remedies are cumulative. Under this approach a contractor who submitted cost or pricing data known to be false, and which caused the Government to overpay an amount of $100,000, would be liable for the following: (1) $200,000 under the Truth in Negotiations Act itself; (2) $300,000 under the civil false claims act; (3) $1,000,000 under the criminal false claims act; and (4) $200,000 under the Program Fraud Statute. Thus the cumulative liability for a knowing $100,000 overcharge would be about $1,700,000. This is in addition to civil penalties and the possibility of debarment or imprisonment.

One of the consequences of the new and enhanced remedies available to the Government is recognition of the need to coordinate implementation of the various remedies and procedures available. Occasionally the Government's pursuit of one remedy has caused it to foreclose other remedies unnecessarily, such as some instances where the contracting activity itself has pursued certain civil remedies while other agencies pursued criminal or other civil actions. The Government's recognition of the existence of this problem is a major step toward a solution, but the ultimate solution will require alertness, cooperation and patience on the part of many people involved in protecting the Government's interests.

Contractual Government Remedies

The Government has a a fairly broad array of contractual remedies available in the event that a contractor fails to fulfill its contractual obligations, and several of them require mention.

Perhaps the most important distinction is between those remedies which involve termination of the contract and those which do not.

Some of the most important remedies available to the Government which do not involve termination are found in the Inspection and Warranty clauses. In those clauses the Government specifies the basic quality control mechanisms and the remedies which correspond to certain types of failures on the part of the contractor.

In the Inspection clause for fixed price supply contracts (FAR Section 52.246-2), for example, the Government reserves the right to inspect and test all supplies called for by the contract. Where the supplies are nonconforming, the clause provides for the Government to (1) reject the items, or (2) require correction of any defects at the contractor's expense, or (3) accept the items at a reduced price to be determined by the Government (and require the contractor to refund payment already made), or (4) have a second contractor correct the deficiencies in the supplies at the expense of the original contractor.

Since these remedies are specified in the contract, the contractor must comply with the Government's order or be in breach of the contract. They are fairly powerful remedies for several reasons: (1) they allow the Government to be selective in their application; (2) they are designed to accomplish the Government's purpose in entering the contract (i.e., to obtain the specified supplies or other performance); and (3) by stopping short of contract termination for default, they provide the contractor an incentive to fulfill his contractual obligations and preserve a still more powerful remedy.

The Inspection clause generally provides these remedies to the Government only until the Government accepts the items supplied, because acceptance implies that the contractor has performed his contractual duty. In this context, "acceptance" means more than receipt of an item; it usually means receipt plus exercising "dominion" or ownership rights over the item. Usually the Government's acceptance of a contractor's performance extinguishes the Government's contractual remedies.

The clause itself says that acceptance is "conclusive, except for latent defects, fraud, gross mistakes amounting to fraud, or as otherwise provided in the contract." Thus there are several situations in which the Government's contractual remedies survive acceptance. Perhaps the broadest of these exceptions is where the contract itself "otherwise provides," which includes any "express warranty" that may be included in the contract.

A warranty is part of the consideration that a contractor gives and the Government receives as part of the bargained-for exchange under the contract. Although there are "implied" warranties such as the implied warranty of "merchantability" (i.e., fitness for ordinary use), in general a warranty does not survive acceptance

unless it is expressly written into the contract. Stated another way, the Government needs to confirm before acceptance that the item purchased conforms to the contractual standards.

If the Government chooses to buy an express warranty from the contractor, however, then the Government's contractual remedies do not expire until the warranty itself expires. In the express warranty, the Government can establish (as a part of the consideration it will receive) whatever standards it believes to be appropriate. See, e.g., FAR Section 52.246-21. Whether an express warranty is appropriate depends on various factors such as the nature of the item, the replacement cost, the probability of damage, and various other consideration specified in FAR Subpart 46.7.

Termination

The Government's ultimate contractual remedy when a contractor defaults is to terminate the contract. The Default clause sets forth the specific situations in which this remedy may be invoked, as well as the mechanics for its use. See, e.g., FAR Section 52.249-8.

In brief, termination for default is available as a remedy for three different types of default: failure to meet the contractual schedule for performance; failure to make progress toward completion of performance, to the extent that performance of the contract is endangered; and failure to perform any other contractual requirement. In addition, there are two considerations which have carried over from the common law.

Termination for default is the Government's remedy for a contractor's breach of contract. Under the common law, an important distinction existed between a material breach of contract and a minor or technical breach which was not material. A breach was said to be "material" if the contractor did not "substantially perform" his contractual duties, and whether there was substantial performance depended on whether the person who hired the contractor received essentially all of the benefit that was due under the contract.

This distinction had meaning because it determined whether certain remedies would be available to the injured party. If the breach was "material," then the injured party could "cover," i.e., have the work done properly and hold the other party liable for paying to have it done. Such a remedy would be analogous to receiving "excess costs of reprocurement." On the other hand, if the breach was not "material," the remedy of the injured party

would generally be limited to a price reduction to reflect the difference in value between what the injured party received and what the contract required the contractor to deliver.

The same distinction is important under Government contracts. Even though the Default clause does not by its terms require that a default be "substantial" before the contract may be terminated for default, that has been held by the courts. One of the leading cases in this area is Radiation Technology, Inc. v. United States, 366 F.2d 1003 (Ct. Cl. 1966); there the Court of Claims explained that a contractor who in good faith meets the delivery schedule but inadvertently delivers goods with minor defects is entitled to an opportunity to cure those minor defects.

However, the materiality of a breach may vary sharply as the facts differ from one case to the next. For example, in the case of Nuclear Research Associates, Inc., ASBCA 13563, 70-1 BCA Para. 8237 (1970), a contractor delivered the procured item early on Monday morning instead of on Friday as required by the contract schedule. Although it was conceded that the Government would not have used the item over the weekend, the Board held that the Government was permitted to terminate the contract for default as soon as the scheduled delivery time had passed.

Thus the materiality of a breach is an important factor in the Government's decision whether to terminate for default, and requires careful consideration because materiality can vary significantly from one set of facts to the next.

The other consideration carried over from the common law is the doctrine of "breach by anticipatory repudiation," sometimes called "anticipatory breach." It refers to the possibility that some time before performance is due, the contractor may declare that he will not perform. Once there is such a repudiation of the contractor's duty to perform, the other party need not wait until the contractor actually fails to perform; the other party may instead treat the repudiation itself as a breach of the contract.

A breach by anticipatory repudiation is similar to a default in which a contractor fails to make progress and thereby endangers performance, but the two are not the same. A contractor may well fail to make progress without repudiating his contractual duty to perform, and a contractor who has already completed much of the contract work ahead of schedule may still repudiate his duty to finish the job.

Thus it can be important to distinguish between these types of actions. Breach by anticipatory repudiation depends on the contractor's statement of intent; failure to make progress depends on the contractor's performance, and the contractor's intent is relevant only insofar as it affects the question of whether performance is endangered by the failure to make progress. Further, although the Default clause requires a 10-day cure notice before the contract can be terminated for failure to

make progress, there is no such requirement if the breach is by anticipatory repudiation. Indeed, in view of the nature of an anticipatory repudiation, and the fact that it must be clear and unambiguous in order to breach the contract, a cure notice would serve no purpose.

These two different actions are sometimes confused, and one common course of action is to cite both anticipatory repudiation and failure to make progress as joint grounds for termination. This practice does little harm, but it fails to make full use of the tools available to the Government. Legal counsel should be sought if the contracting officer thinks that either of these remedies might be appropriate.

Negotiation and Settlement

Having reviewed the Claims and Disputes processes, including such remedies as termination for default and even debarment, civil penalties, fines and imprisonment, it is appropriate to recall that litigation and other adversary proceedings are not usually the Government's first preference in resolving a dispute. Rather, attorneys usually consider litigation to be an unfortunate necessity when a dispute cannot be resolved some other way.

There are several reasons for this view. First, litigation causes the client (whether the Government or the contractor) to incur substantial costs, in terms of money,time delays and uncertainty related to litigation. Secondly, litigation adds to the burdens imposed on the client's employees, diverting their attention and energies from productive activities.

The third reason is that there is always a risk of losing even the strongest case. Witnesses can become ill and not available to testify. People forget. People make mistakes. Workpapers can be lost or destroyed. And reasonable people can differ as to interpretations of the contract, the facts, the circumstances, or the evidence.

For these reasons, litigation is not the preferred means of dispute resolution; the preferred means is negotiation. Contract administrators need to be aware that the term "negotiation" does not imply that either party will concede anything, but only that each side will listen to what the other has to say and give it due consideration. It always makes sense to know what the other side is thinking, and it usually costs little to find out.

The role and mechanics of negotiations in connection with claims and disputes in government contracting are discussed in the following article, which requires two brief comments. First, in its discussion of The Ground Rules, the article uses the terms "apparent authority" and "implied authority" interchangeably.

The doctrine of "apparent authority" generally applies where a person creates the false impression that an agent is authorized to act for him; once a third party suffers an injury as a result of relying on the agent's apparent authority, the courts will not usually allow the person who created the false impression to avoid liability by claiming that the agent was not authorized or exceeded his authority. Although commercial parties are generally bound by this doctrine of apparent authority, the Government is not bound by it, and is usually not bound by the acts of its agents who exceed their authority.

In contrast, the term "implied authority" usually refers to an agent's actual authority to take certain actions in behalf of the principal (usually the agent's employer) which were not actually expressed when the agent was designated as an agent. For example, a contracting officer with express authority to both enter and terminate contracts would probably also have some implied authority to modify those same contracts. The term "implied authority" thus does apply to the Government.

The second comment needed by the accompanying article is that it should perhaps emphasize more that negotiations can continue during litigation, and even after litigation. Such negotiations may be fruitful, but they can also be risky. Statements made during negotiations sometimes return to haunt the person who made them, such as where the person perhaps assumed an implicit mutual understanding that the discussion would be "off the record." Once a dispute appears to be headed for litigation, and certainly after litigation has begun, it is essential that legal counsel be fully informed and consulted before any attempt at negotiation is undertaken.

THE DISPUTES PROCESS IN GOVERNMENT CONTRACTS

This article will concern itself with the disputes process in the Government contract context. We will study the nature of the process, both old and new. This is so because the Contract Disputes Act of 1978 (hereafter the CDA) has significantly changed the historical disputes procedure by the introduction of a statutory process with major differences for resolving conflicts arising under a Government contract.

1. "Dispute" defined.

1-1. A "dispute" must be more than a mere disagreement between the contracting parties. To launch the disputes process and to put an end to the discussions concerning the disagreement, a final decision by the Contracting Officer is required.

1-2. Once such final decision is made, we are thereafter engaged in the "verbal controversy" which is the dictionary definition of "dispute." Although another dictionary definition of "disputes" is to "argue irritably or with irritating persistence," the disputes process is intended to put an end to such disputation by the proceeding now established by statute.

1-3. A dispute is an honorable proceeding. Honest disputes over performance and interpretation of contract provisions can arise in even the smoothest contract situations. However, honest differences do not indicate bad faith by the questioning party. Even the clearest contract terms and conditions can give rise to the necessity of interpretation. Resolution by mutual agreement is frequently possible. When agreement is not possible, statutory or regulatory resolution is provided. Such resolution takes the form of administrative of judicial remedies.

1-4. Historically, administrative remedies, by virtue of regulatory provisions, were provided for by contract provision, e.g., the Disputes Clause. Judicial remedies, provided for by statute, were available in certain cases where the Government waived its sovereign immunuity and consented to be sued. The principle that "one must exhaust one's administrative remedies before seeking a judicial remedy" prevailed until the passage of the CDA.

2. The Pre-CDA Disputes Clause.

2-1. The standard pre-CDA Disputes Clause was contained in the General Provisions of the fixed-price supply contract. It read as follows:

Disputes

(a) Except as otherwise provided in this contract, any dispute concerning a question of fact arising under this contract which is not disposed of by agreement shall be decided by the Contracting Officer, who shall reduce his decision to writing and mail or otherwise furnish a copy thereof to the Contractor. The decision of the Contracting Officer

shall be final and conclusive unless, within 30 days from the date of receipt of such copy, the Contractor mails or otherwise furnishes to the Contracting Officer a written appeal addressed to the Secretary. The decision of the Secretary or his duly authorized representative for the determination of such appeals shall be final and conclusive unless determined by a court of competent jurisdiction to have been fraudulent, or capricious, or arbitrary, or so grossly erroneous as necessarily to imply bad faith, or not supported by substantial evidence. In connection with any appeal proceeding under this clause, the Contractor shall be afforded an opportunity to be heard and to offer evidence in support of its appeal. Pending final decision of a dispute hereunder, the Contractor shall proceed diligently with the performance of the contract and in accordance with the Contracting Officer's decision.

(b) This "Disputes" clause does not preclude consideration of law questions in connection with decisions provided for in paragraph (a) above, provided, that nothing in this contract shall be construed as making final the decision of any administrative official, representative, or board on a question of law.

2-2. A thorough understanding of this clause is necessary for two reasons: (1) disputes arising prior to the effective date of the CDA (1 March 1979) may still be in the process of resolution under this provision, and (2) the new Disputes Clause under the CDA (which follows, infra) presumes knowledge of the disputes process as more clearly defined by the historical provision, above.

2-3. Since this clause is more than of mere historical significance, a further study of its provisions is in order. An analysis of its provisions follows:

(a) "Except as otherwise provided in this contract. . ." This phrase suggests that other methods of resolution of dispute provided by the contract, e.g., liquidated damages, may be in order.

(b) ". . .any dispute concerning a question of fact arising under this contract which is not disposed of by agreement. . ." It becomes clear that this administrative resolution is concerned with the disposition of issues of fact. We also note that disposal of disputes by agreement between the parties is emphasized and encouraged by reference to such disposition.

(c) ". . .shall be decided by the Contracting Officer. . ." At this point, the realities of contracting with the Government strike home. The uninitiated contractor may be shocked to learn that the so-called equal bargaining positions of the parties seem to be contradicted by a provision permitting a unilateral decision by the Government's agent on questions of paramount importance.

(d) ". . .who shall reduce his decision to writing and mail or otherwise furnish a copy therefore to the Contractor." This is the first element of due process - fair notice. There must be a writing and the writing must be furnished the Contractor.

(e) "The decision of the Contracting Officer shall be final and conclusive unless, within 30 days from the date of receipt of such copy the Contractor mails or otherwise furnishes to the Contracting Officer a written

appeal addressed to the Secretary." This portion of the clause does not mean what it purports to say. The 30-day limitation, though firm in the opinion of the ASBCA (Maney Aircraft Parts, Inc., ASBCA 14363, 70-1 BCA 8076) was considered by the Court of Claims to be contractual, not jurisdictional, and thereby waivable for "good cause" or "justifiable excuse," (Ct. Cl. 191-70, June 20, 1973). Further, appeals addressed to the Contracting Officer were considered proper by virtue of the law of agency whereby notice to the agent is imputed to the principal.

(f) "The decision of the secretary. . . .etc. . ." is probably the most noteworthy portion of the clause since it embodies the Anti-Wunderlich Act (see infra) grounds for appeal of administrative determinations on questions of fact: ". . .fraudulent, or capricious, or arbitrary, or so grossly erroneous as necessarily to imply bad faith or not supported by substantial evidence." The student of Administrative Law will recognize these grounds as being in common and general use in the administrative appeals process. Unfortunately, the latest disputes provision (which follows) does not call out these elements, referring only to the CDA which continues to recognize these Anti-Wunderlich standards. Of great significance to both the Government and the contractor, the parties are now imputed with knowledge of these standards by operation of law, since they are included in the statute (CDA) even though no longer in the regulation (Disputes Clause).

(g) "In connection with any appeal proceeding under this clause, the contractor shall be afforded an opportunity to be heard and to offer evidence in support of its appeal." This is the other element of due process:an opportunity to be heard. This portion of the clause is cursory and incomplete. Offering evidence in support of an appeal is only part of the story. Everything required by administrative due process is included, e.g., a fair hearing in a proper forum, a good record, the opportunity to cross-examine, proper rules of procedure, etc.

(h) "Pending final decision of a dispute hereunder, the contractor shall proceed diligently with the performance of the contract and in accordance with the Contracting Officer's decision." Here, again, we squarely face the unilateral authority of the sovereign in making a decision binding the contractor to continued performance, though it may vehemently disagree with such decision. The penalty for failure to continue performance would be a breach of the contract and a total termination by default.

(i) The balance of the clause (sub-paragraph (b)) reiterates the Anti-Wunderlich Act caveat that questions of law, though considered in the administrative adjudication, can only be finally resolved under the judicial function.

There we have it - administrative adjudication explained in brief. This "old" clause is still operative. It contains elements which the "new" clause omits; it appears to be more definitive and precise in its terminology; it is the fundament for a thorough understanding of the disputes procedure, whether historical or current. It cannot be dismissed as of no further force and effect, and it must be thoroughly understood and digested by the serious student of administrative procedure.

3. The Disputes Process in Historical Perspective.

3-1. An important part of understanding the disputes process is a study of the major historical events leading up to the CDA of 1978. These significant procedural events follow:

(a) U.S. v. Wunderlich (342 U.S. 98, 1951). In this case, the contractor sued in the Court of Claims, following a disagreement with the contracting officer's decisions on various disputes during performance of a contract to build a dam. The Court of Claims granted relief on the basis that the departmental decision was "arbitrary," "capricious," and "grossly erroneous." Fraud was not alleged nor proved. The Supreme Court held that the finality of the department head's decision must be upheld unless it were founded on fraud, alleged and proved. Citing cases upholding the finality of departmental decision-making (U.S. v. Moorman, 338 U.S. 457) and the necessity of proving fraud (U.S. v. Colorado Anthracite Co., 225 U.S. 219, 226) or at least gross mistake implying bad faith (Ripley v. U.S., 223 U.S. 695, 704) in order to gain relief, the only ameliorating factor of what otherwise could be considered a harsh anti-contractor position was the Court's statement. . . "If the standard of fraud that we adhere to is too limited, that is a matter for Congress."

(b) The Administrative Disputes Act of 1954 (Anti-Wunderlich Act), 41 U.S.C. Sec 321 and 322, May 11, 1954. By this Act, Congress acted to ameliorate the impact of the decision in the Wunderlich case. Simply stated, four new grounds for relief from administrative decisions on questions of fact were added to the court-mandated standard of fraud: "capricious, or arbitrary or so grossly erroneous as necessarily to imply bad faith, or is not supported by substantial evidence."

(c) U.S. v. Carlo Bianchi & Co., Inc., 373 U.S. 709 (1963). In another construction contract involving the building of a diversionary tunnel, the Contractor sought relief under the Changed Conditions (now Differing Site Conditions) article of the contract. Following the denial of its appeal before Board of Claims and Appeals of the Corps of Engineers(1948), the Contractor appealed to the Court of Claims (1954) under the new Anti-Wunderlich standards. The Courts's Commissioner (now Trial Judge) allowed the introduction of new evidence (de novo) despite the Government's position that the review should be made on the administrative record. Citing Volentine and Littleton v. U.S., 136 Ct. Cl. 638, the Court held that trial in the Court of Claims should not be limited to the administrative record, but should be de novo. The Government appealed to the U.S. Supreme Court. That Court reversed, with well-reasoned dissents, the majority upholding the principle that appeals shall be made on the administrative record. The contractor, however, was ultimately victorious wherein by Private Law 91-234 (January 2, 1971) its case was reviewed by ENGBCA which decided some 27 years (August 30, 1973) after the contract was initiated that the contractor was entitled to its claim." Knowledgeable contracting personnel still refer to protracted, long-continuing, and still unresolved matters by the epitaph "Shades of Bianchi's ghost!"

(d) U.S. v. Utha Construction and Mining Co., 384 U.S. 394 and U.S. v. Anthony Grace & Sons Inc., 384 U.S. 424 (1966). These cases, both heard on the same day by the Supreme Court, reaffirmed the importance of the

administrative remedy and the exhaustion of such remedy before seeking judicial relief. It was reiterated that the record made before the Board was the record upon which an appeal would be made. There would be no trail do novo except in certain exceptional situations. Once again, the Supreme Court resoundingly reaffirmed its support for the administrative process.

(e) S & E Contractors, Inc. v. U.S., 406 U.S. 1, (1972). Here again, a construction contractor with the AEC was refused payment for certain claims upon which the parties in privity were agreed. However, the Comptroller General and, later, the Department of Justice refused to recognize the accord and took a position contra both the AEC and S&E. The Government, in fact, was appealing its own decision! Was this a "dispute" within the purview of the Disputes Clause? The matter was resolved when the Supreme Court, in one fell swoop, took the Comptroller General out of the contract appeals process and denied the Department of Justice's claim of the right to represent the Government in appealing a decision of an administrative agency, other than in cases involving fraud. So we see that the attempts to interpret and clarify the provisions of the Administrative Disputes Act of 1954 (Anti-Wunderlich Act) continued, leading to the ultimate resolution in the CDA of 1978.

(e) The Contract Disputes Act of 1978 (P.L. 95-563; 92 Stat 2383). The Act culminated the long process of interpretation of administrative resolution of contract disputes. We will analyze its provisions below.

4. The Contract Disputes Act of 1978.

4-1. The Act, following certain reforms proposed by the Commission on Government Procurement (1972) provides for significant changes in Government contract remedies. It in fact "judicializes" the disputes process to a high degree. It provides for procedures that shall be followed in all contracts entered into since 1 March 1979.

4-2. The CDA in its entirety can be found under Chapter 16 of Appendix G in this text. However, a brief summary of its most pertinent provisions is in order:

(1) It confers jurisdiction in Boards of Contract Appeals on "all claims arising under (or related to) the contract." The Boards thereafter have had authority to hear and decide not only the usual, historical disputed claims, (e.g., constructive changes; equitable adjustments), but also claims involving reformation, recission or breach of contract.

(2) The 30-day appeal period following a Contracting Officer's final decision is now extended to 90 days.

(3) A certification requirement has been added. The Contractor must now certify that its claim is accurate and complete to the best of the Contractor's knowledge and belief and that the claim is made in good faith.

(4) The Office of Federal Procurement Policy (OFPP) gains additional stature by becoming involved in the organization of Boards of Contract Appeals and in issuing rules of procedure in administrative adjudication by such boards.

(5) The Contractor now has the option of choosing an administrative or judicial remedy. It may now appeal to a BCA or directly to the Court of Claims.

(6) The Government now can seek judicial review of board decisions (contra S & E, supra).

(7) Interest on Contractor claims now accrues from the date the claim is received rather than from the date of the Contracting Officer's decision.

(8) Stiff anti-fraud provisions on contractor claims are now operative.

(9) Except for TVA cases, District Courts no longer have jurisdiction over Contractor appeals.

(10) BCA personnel are subject to a careful selection process and board status and prestige is further enhanced.

4-3. As a result of the CDA, Boards of Contract Appeals now appear to have the status and jurisdictional authority of "administrative courts." This is not surprising in that the entire history of the administrative process as reviewed in the significant procedural events in the historical perspective of the disputes process, above, has favored the establishment of such adjudicatory bodies.

4-4. In summary, we now have statutory authority supporting the process of settlement of disputes on Government contracts. With the enhancement of the status and jurisdictional authority of Boards of Contract Appeals under the CDA, we can expect continued growth in significant decisions affecting Government contract relationships.

5. The "New" Disputes Clause.

5-1. The CDA of 1978 was the "enabling" act. It remained for the regulation (DAR) to implement the Act by incorporating its provisions, in part, in the "new" Disputes Article.

5-2. At least two "temporary" or "interim" disputes clauses were tried and discarded. Implementing the Act by regulatory provisions became no small task. The resulting 1980 DAR clause requires the same type of analysis which we afforded the "old" Disputes Clause earlier in this chapter. First, however, the clause in its entirety follows.

5-3. Disputes (1980 June)

(a) This contract is subject to the Contract Disputes Act of 1978 (P.L. 95-563).

(b) Except as provided in the Act, all disputes arising under or relating to this contract shall be resolved in accordance with this clause.

(c) (1) As used herein, "claim" means a written demand or assertion by one of the parties seeking, as a matter of right, the payment of money, adjustment, or interpretation of contract terms, or other relief, arising under or relating to this contract. However, a written demand by the Contractor seeking the payment of money in excess of $50,000 is not a claim until certified in accordance with (d) below

(2) A voucher, invoice, or other routine request for payment that is not in dispute when submitted is not a claim for the purposes of the Act. However, where such submission is subsequently disputed either as to liability or amount or not acted upon in a reasonable time, it may be converted to a claim pursuant to the Act by complying with the submission and certification requirements of this clause.

(3) A claim by the Contractor shall be made in writing and submitted to the Contracting Officer for decision. A claim by the Government against the Contractor shall be subject to a decision by the Contracting Officer.

(d) For contractor claims of more than $50,000, the Contractor shall submit with the claim a certification that the claim is made in good faith, the supporting data are accurate and complete to the best of the contractor's knowledge and belief and the amount requested accurately reflects the contract adjustment for which the Contractor believes the Government is liable. The certification shall be executed by a senior company official in charge at the Contractor's plant or location involved, or by an officer or general partner of the Contractor having overall responsibility for the conduct of the Contractor's affairs.

(e) For contractor claims of $50,000 or less, the Contracting Officer must, if requested in writing by the contractor, render a decision within 60 days of the request. For contractor-certified claims in excess of $50,000, the Contracting Officer must decide the claim within 60 days or notify the Contractor of the date when the decision will made.

(f) The Contracting Officer's decisions shall be final unless the Contractor appeals or files a suit as provided in the Act.

(g) Interest on the amount found due on a contractor claim shall be paid from the date the Contracting Officer receives the claim, or from the date payment otherwise would be due, if such date is later, until the date of payment.

(h) The Contractor shall proceed diligently with performance of this contract, pending final resolution of any request for relief, claim, appeal, or action arising under the contract, and comply with any decision of the Contracting Officer.

(End of Clause)

5-4. An agency instruction illustrating the use of the alternate (h) paragraph, referred to in the Disputes Clause above follows:

> DAR 1-314(k)(2). In general, prior to passage of the Act, the obligation to continue performance applied only to claims arising under a contract. However, Section 6(b) of the Act authorizes contracting agencies to include a provision requiring a contractor to continue performance of a contract in accordance with the contracting officer's decision pending final decision on a claim relating to the contract. In unusual circumstances the performance of some contracts may be so vital to the national security or to the public health and welfare that performance must be guaranteed even in the event of a dispute that may be characterized as a claim relating to, as opposed to arising under, the contract. In recognition of this fact, an alternative provision is provided for paragraph (h) of the Disputes Clause at 7-103.12 (b).

(3) The acquisitions of aircraft, naval vessels, missiles, tracked combat vehicles, and related electronic systems shall include the alternate provision at 7-103.12(b). In addition, the alternate provision at 7-103.12(b) may also be used in those contracts or classes of contracts where it has been determined, in accordance with Department procedures, that it is essential because of the unusual circumstances described in (k)(2) above. The determination to use the alternate provision at 7-103.12(b) in other situations shall be made by the head of the contracting activity responsible for the acquisition involved. Examples of the types of unusual circumstance where continued performance may be determined to be vital to the national security or public health and welfare include the acquisition of weapons, support systems, and related components other than those listed above, or other essential supplies or services whose timely reprocurement from other sources would be impracticable. In all contracts employing the alternate provision at 7-103.12(b), in the event of a dispute not arising under but relating to the contract, agencies should consider providing, through appropriate department procedures, financing of the continued performance, provided, that the Government's interests are properly secured.

5-5. Following is a brief analysis of the provisions of this new Disputes Clause.

(a) "This Contract is subject to the Contract Disputes Act of 1978." This sentence simply affirms the statutory nature of the disputes process. Caveat, however, by this broad, general statement, one involved in Government contracts is presumed to know the content and requirements of the CDA.

(b) "Except as provided in the Act, all disputes arising under or relating to this contract shall be resolved in accordance with this clause." This broad grant of authority reaffirms that the act applies to all disputes on matters "arising under or relating to" the contract. Thus, BCA's now have all of their old authority as well as the new authority to decide disputes "relating to" the contract. The agency boards now have the same powers as the

Court of Claims to grant relief in respect to claims arising under the Act. Since relief may be granted in "all disputes," it may extend to cases involving breach of contract and certain kinds of relief formerly available only under P.L. 85-804, i.e., rescission or reformation for mutual mistake. Note, however, that not all requests for relief under P.L. 85-804 are considered claims under the CDA. Note, also, that contracts with foreign governments, international organizations, or agencies thereof are exempted if the Secretary determines that such exception is in the public interest.

(c) The clause carefully defines certain significant terms in subparagraph (c), e.g., "claim," "voucher, invoice, or other routine request for payment. . ." It is interesting to note that the clause states that a written demand by the Contractor seeking payment is not a claim until certified under the provision below. The Act clearly does not require certification of all claims at the time such claims are made. Subparagraph (c)(iii) continues to require a writing and a Contracting Officer's decision.

(d) "For contractor claims of more than $50,000, the contractor shall submit. . . . .a certification. . . ." This subparagraph requires a certification of the Contractor's claim. Since the Act specifies penalties for fraudulent claims, the certification cannot be taken lightly by the contracting parties. Mixed views about such certification prevail; what is certain, however, is that certification is here to stay. Quaere: After certifying a firm claim, can the Contractor accept a lower settlement without becoming vulnerable to charges of fraudulent claim? Quaere, further: What impact will this provision have vis a vis contractor notification of claims (DAR Section XXVI) and the economic consequences of early submittal where interest on such claim is concerned?

(e) "For contractor claims of $50,000 or less, the Contracting Officer must. . . .render a decision within 60 days. . . ." Here we have an attempt to "deadline" Contracting Officer's decision-making. It should be understood that the reasonableness of the specified time periods will depend on many relevant factors, e.g., the adequacy of supporting data; the size and complexity of the claim, etc.

(f) "The Contracting Officer's decision shall be final unless the contractor appeals or files a suit as provided in the Act. Once again, the contractor is presumed to know what the Act requires. No longer do the Anti-Wunderlich grounds (i.e., fraudulent, or capricious, or arbitrary . . . etc.) appear in the clause (though retained in the Act). DAR 1-314(i)(2) is of some help; the novice Contractor, however, will undoubtedly need considerable assistance in prosecuting its appeal under the CDA.

(g) Interest on the amount found due on a contractor claim. . ." Interest on Contractors' claims now has a statutory basis. It shall now be paid from the date of receipt of the claim by the Contracting Officer, or from the date payment otherwise would be due until the date payment is made. The interest rate shall be at rates periodically fixed by the Secretary of the Treasury.

(h) The (h) and alternate (h) clauses require thee Contractor to continue performance pending resolution of any appeal, claim, action or

request for relief. Subparagraph 9h) deals with such matters "arising under the contract; alternate (h) extends to action "arising under or related to" the contract. It is clear that the purpose of adjudication under this clause, whether administrative or judicial, is to render relief that is quick, inexpensive and expedient while the parties in privity continue performance, if such remains. Alternate (h) recognizes that performance of some contracts may be so vital to national security or to the public health and welfare that such performance must be guaranteed regardless of the nature of the dispute or claim.

5-6. At this point, a general comment concerning the purpose of the Act is in order. Foremost, the Government's policy continues to be to resolve disputes by mutual agreement. Informal discussions seeking to resolve troublesome issues are encouraged. The Contracting Officer continues to be the central figure in the disputes process and is authorized, within his or her warrant, to decide or settle all claims relating to the contract. However, such authority does not extend to a claim or dispute for penalties or forfeitures which another agency, by statute, is authorized to determine or to any claim involving fraud. It is obvious that the CDA not only enhanced the authority of the BCAs but also that of the Contracting Officer.

5-7. And, finally, we arrive at the latest version of the Disputes Clause, which once again, slightly revised the form without seriously affecting the substance. The FAR provision (52.233-1) follows at the end of this chapter.

6. Summary of Changes.

6-1. Now that we have dissected the disputes articles, old and new, and have absorbed the administrative adjudicatory process in historical perspective, a summary of changes as a quick-reference is in order.

6-2. The table that follows contains, in columnar format, the action or event (in order of its appearance in the CDA), the result or requirement under the CDA of 1978.

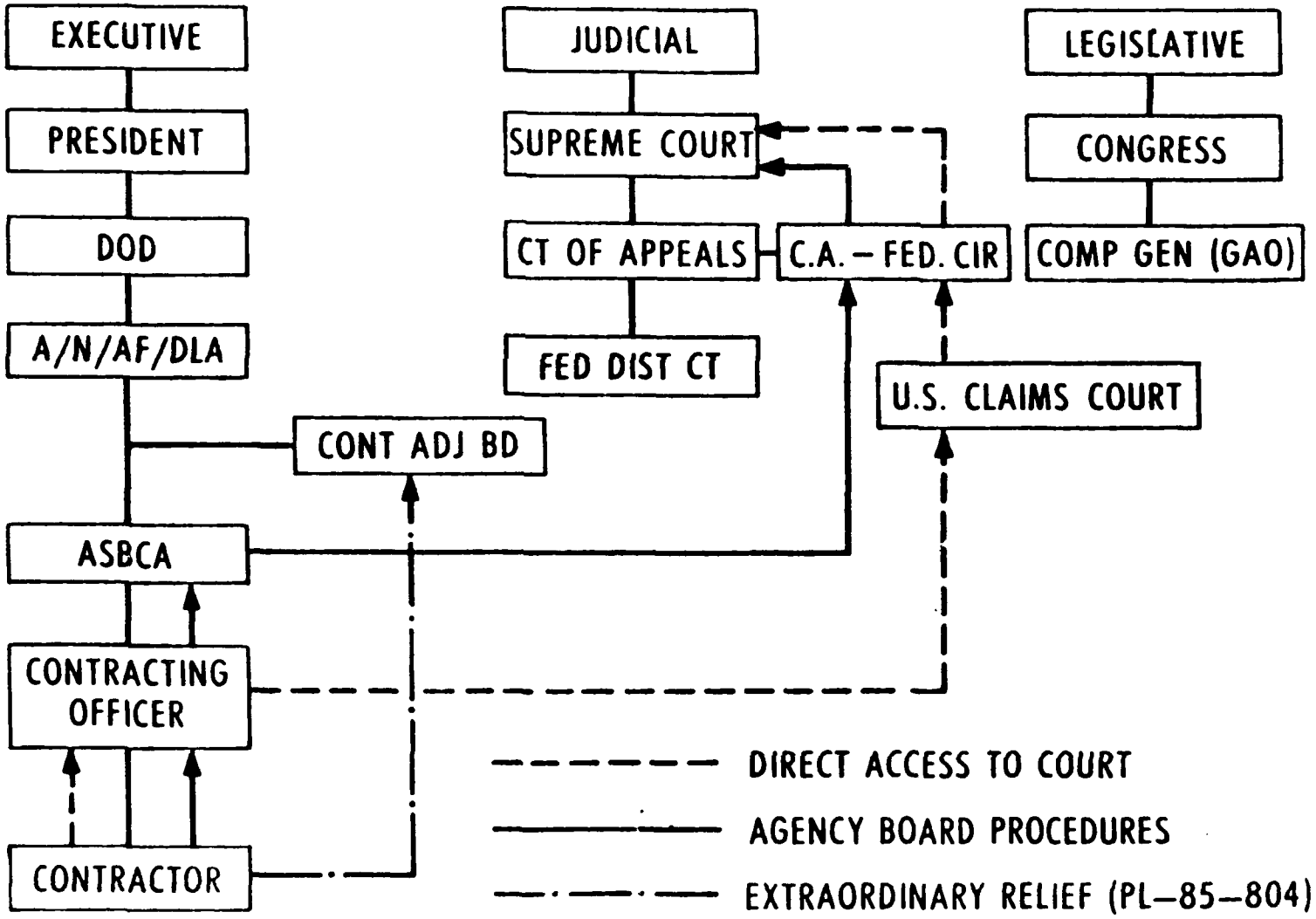
6-3. Also, a Roadmap of Contractor Remedies is added at the end of this chapter to assist the reader in a clearer understanding of the The Federal Courts Improvement Act (FCIA), which has changed the appellate process in contract disputes.

THE DISPUTES PROCESS

		PRE-CDA	CDA OF 1978
1.	Fraudulent claims	Not covered as such	Contractor liable for amount equal to unsupported part of claims plus costs for up to 6 years from commission.
2.	Time limit on Contracting Officer's decisions	Reasonable time	Up to $50,000-60 days. Over $50,000-60 days or notice of additional time required.
3.	Claims certification	Not required	Required over $50,000
4.	Appeal to BCA	30 days	90 days
5.	BCA's	Established and regulated by agency	Statutory coverage; OFPP/Agency
6.	Accelerated procedure (Before BCA's)	Up to $25,000	Up to $50,000 at Contractor's option; 180 day deadline for decision
7.	Appeal of BCA decisions to Court of Appeals for the Federal Circuit		
	Contractor	6 years	120 days
	Government	No right of appeal	120 days with HCA and Attorney General Approval
8.	U.S. District Courts	Juris up to $10,000	No juris. (except in TVA cases)
9.	Small claims (Before BCA's)	Covered under accelerated procedure above	Up to $10,000, non-appealable decision required within 120 days
10.	Direct access to U.S. Claims Court by Contractor	Only on pure questions of law	Up to 12 months from Contracting Officer's decision
11.	CAFC action upon appeal	Limited to review of the record	Same
12.	BCA finality	Only on questions of fact; Anti-Wunderlich Act standards apply	Same
13.	BCA jurisdiction	Questions of fact arising under the contract	"All claims" arising under (or related to) the contract
14.	BCA subpoena power	None	Authorized; enforceable through USDC
15.	Interest on Contractor claims	Payable from date of Contracting Officer's Decision	Payable from date Contracting Officer receives claim

EJS/5 Mar 84

ROADMAP OF CONTRACTOR REMEDIES



J-56

EFF: 1 OCT 82

THE ADMINISTRATIVE DISPUTES ACT OF 1954

(The Anti-Wunderlich Act)

(41 U.S.C. §§ 321-322)

§ 321. LIMITATION OF PLEADING CONTRACT-PROVISIONS RELATING TO FINALITY; STANDARDS OF REVIEW

No provision of any contract entered into by the United States, relating to the finality or conclusiveness of any decision of the head of any department or agency or his duly authorized representative or board in a dispute involving a question arising under such contract, shall be pleaded in any suit now filed or to be filed as limiting judicial review of any such decision to cases where fraud by such official or his said representative or board is alleged: Provided, however, that any such decision shall be final and conclusive unless the same is fraudulent, capricious, or arbitrary or so grossly erroneous as necessary to imply bad faith, or is not supported by substantial evidence. May 11, 1954, c. 199, § 1, 68 Stat. 81.

§ 322. CONTRACT-PROVISIONS MAKING DECISIONS FINAL ON QUESTIONS OF LAW

No Government contract shall contain a provision making final on a question of law the decision of any administrative official, representative, or board. May 11, 1954, c. 199, § 2, 68 Stat. 81.

CONTRACT DISPUTES ACT OF 1978 P.L. 95-563

(41 U.S.C. § 601)

As Amended by the Federal Courts Improvement Act of 1982, HR 4482.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Contracts Disputes Act of 1978".

§ 601. Definitions

As used in this Act --

(1) the term "agency head" means the head and any assistant head of an executive agency, and may "upon the designation by" the head of an executive agency include the chief official of any principal division of the agency;

(2) the term "executive agency" means an executive department as defined in § 101 of title 5, United States Code, an independent establishment as defined by § 104 of title 5, United States Code (except that it shall not include the General Accounting Office) a military department as defined by § 102 of title 5, United States Code, and a wholly owned Government corporation as defined by § 846 of title 31, United States Code, the United States Postal Service, and the Postal Rate Commission;

(3) the term "contracting officer" means any person who, by appointment in accordance with applicable regulations, has the authority to enter into and administer contracts and make determinations and findings with respect thereto. The term also includes the authorized representative of the contracting officer, acting within the limits of his authority;

(4) the term "contractor" means a party to a Government contract other than the Government;

(5) the term "Administrator" means the Administrator for Federal Procurement Policy appointed pursuant to the Office of Federal Procurement Policy Act;

(6) the term "agency board" means an agency board of contract appeals established under § 8 of this Act; and

(7) the term "misrepresentation of fact" means a false statement of substantive fact, or any conduct which leads to a belief of a substantive fact material to proper understanding of the matter in hand, made with intent to deceive or mislead.

§ 602. **Applicability of Law**

(a) Unless otherwise specifically provided herein, this Act applies to any express or implied contract (including those of the non-appropriated fund activities described in §§ 1346 and 1491 of title 28, United States Code) entered into by an executive agency for --

(1) the procurement of property, other than real property in being;

(2) the procurement of services;

(3) the procurement of construction, alteration, repair or maintenance of real property; or

(4) the disposal of personal property.

(b) With respect to contracts of the Tennessee Valley Authority, the provisions of this Act shall apply only to those contracts which contain a disputes clause requiring that a contract dispute be resolved through an agency administrative process. Notwithstanding any other provision of this Act, contracts of the Tennessee Valley Authority for the sale of fertilizer or electric power or related to the conduct or operation of the electric power system shall be excluded from the Act.

(c) This Act does not apply to a contract with a foreign government, or agency thereof, or international organization, or subsidiary body thereof, if the head of the agency determines that the application of the Act to the contract would not be in the public interest.

§ 603. **Maritime Contracts**

Appeals under paragraph g of § 8 and suits under § 10, arising out of maritime contracts, shall be governed by the Act of March 9, 1920, as amended (41 Stat. 525, as amended; 46 U.S.C. §§ 741-752) or the Act of March 3, 1925, as amended (43 Stat. 1112, as amended; 46 U.S.C. §§ 781-790) as applicable, to the extent that those Acts are not inconsistent with this Act.

§ 604. **Fraudulent Claims**

If a contractor is unable to support any part of his claim and it is determined that such inability is attributable to misrepresentation of fact or fraud on the part of the contractor, he shall be liable to the Government for an amount equal to such unsupported part of the claim in addition to all costs to the Government attributable to the cost of reviewing said part of his claim. Liability under this subsection shall be determined within 6 years of the commission of such misrepresentation of fact or fraud.

§ 605. **Decision by Contracting Officer**

(a) All claims by a contractor against the Government relating to a contract shall be in writing and shall be submitted to the contracting officer for a decision. All claims by the Government against a contractor relating to a contract shall be the subject of a decision by the contracting officer. The contracting officer shall issue his decisions in writing, and shall mail or otherwise furnish a copy of the decision to the contractor. The decision shall state the reasons for the decision reached, and shall inform the contractor of his rights as provided in this Act. Specific findings of fact are not required, but if made, shall not be binding in any subsequent proceeding. The authority of this subsection shall not extend to a claim or

dispute for penalties or forfeitures prescribed by statute or regulation which another Federal agency is specifically authorized to administer, settle or determine. This section shall not authorize any agency head to settle, compromise or pay or otherwise adjust any claim involving fraud.

(b) The contracting officer's decision on the claim shall be final and conclusive and not subject to review by any forum, tribunal, or Government agency, unless an appeal or suit is timely commenced as authorized by this Act. Nothing in this Act shall prohibit executive agencies from including a clause in Government contracts requiring that pending final decision of an appeal or suit, or final settlement, a contractor shall proceed diligently with performance of the contract in accordance with the Contracting Officer's decision.

(c)(1) A contracting Officer shall issue a decision on any submitted claim of $50,000 or less within sixty days from his receipt of a written request from the contractor that a decision be rendered within that period. For claims of more than $50,000, the contractor shall certify that the claim is made in good faith, and that the supporting data are accurate and complete to the best of his knowledge and belief, and that the amount requested accurately reflects the contract adjustment for which the contractor believes the Government is liable.

(2) A contracting officer shall, within sixty days of receipt of a submitted certified claim over $50,000 --

(A) issue a decision; or

(B) notify the contractor of the time within which a decision will be issued.

(3) The decision of a contracting officer on submitted claims shall be issued within a reasonable time, in accordance with regulations promulgated by the agency, taking into account such factors as the size and complexity of the claim and the adequacy of the information in support of the claim provided by the contractor.

(4) A contractor may request the agency board of contract appeals to direct a contracting officer to issue a decision in a specified period of time, as determined by the board, in the event of undue delay on the part of the contracting officer.

(5) Any failure by the contracting officer to issue a decision on a contract claim within the period required will be deemed to be a decision by the contracting officer denying the claim and will authorize the commencement of the appeal or suit on the claim as otherwise provided in this Act. However, in the event an appeal or suit is so commenced in the absence of a prior decision by the contracting officer, the tribunal concerned may, at its option, stay the proceedings to obtain a decision on the claim by the contracting officer.

§ 606. **Contractor's Right of Appeal to Board of Contract Appeals**

Within ninety days from the date of receipt of a contracting officer's decision under § 6, the contractor may appeal such decision to an agency board of contract appeals, as provided in § 8.

§ 607. **Agency Boards of Contract Appeals**

(a)(1) Except as provided in paragraph (2) an agency board of contract appeals may be established within an executive agency when the agency head, after consultation with the Administrator, determines from a workload study that the volume of contract claims justifies the establishment of a full-time agency board of at least three members who shall have no other inconsistent duties. Workload studies will be updated at least once every three years and submitted to the Administrator.

(2) The Board of Directors of the Tennessee Valley Authority may establish a board of contract appeals for the Authority of an indeterminate number of members.

(b)(1) Except as provided in paragraph (2), the members of agency boards shall be selected and appointed to serve in the same manner as hearing examiners appointed pursuant to § 3105 title 5 of the United States Code, with an additional requirement that such members shall have had not fewer than five years' experience in public contract law. Full-time members of agency boards serving as such on the effective date of this Act shall be considered qualified. The chairman and vice chairman of each board

shall be designated by the agency head from members so appointed. The chairman of each agency board shall receive compensation at a rate equal to that paid a GS-18 under the General Schedule contained in § 5332, United States Code, the vice chairman shall receive compensation at a rate equal to that paid a GS-17 under such General Schedule, and all other members shall receive compensation at a rate equal to that paid a GS-16 under such General Schedule. Such positions shall be in addition to the number of positions which may be placed in GS-16, GS-17, and GS-18 of such General Schedule under existing law.

(2) The Board of Directors of the Tennessee Valley Authority shall establish criteria for the appointment of members to its agency board of contract appeals established in subsection (a)(2), and shall designate a chairman of such board. The chairman of such board shall receive compensation at a rate equal to the daily rate paid of a GS-18 under the General Schedule contained in § 5332, United States Code for each day he is engaged in the actual performance of his duties as a member of such board. All other members of such board shall receive compensation at a rate equal to the daily rate paid a GS-16 under such General Schedule for each day they are engaged in the actual performance of their duties as members of such board.

(c) If the volume of contract claims is not sufficient to justify an agency board under subsection (a) or if he otherwise considers it appropriate, any agency head shall arrange for appeals from decisions by contracting officers of his agency to be decided by a board of contract appeals of another executive agency. In the event an agency head is unable to make such an arrangement with another agency, he shall submit the case to the Administrator for placement with an agency board. The provisions of this subsection shall not apply to the Tennessee Valley Authority.

(d) Each agency board shall have jurisdiction to decide any appeal from a decision of a contracting officer (1) relating to a contract made by its agency, and (2) relating to a contract made by any other agency when such agency or the Administrator has designated the agency board to decide the appeal. In exercising this jurisdiction, the agency board is authorized to grant any relief that would be available to a litigant asserting a contract claim in the Claims Court.

(e) An agency board shall provide, to the fullest extent practicable, informal, expeditious, and inexpensive resolution of disputes, and shall issue a decision in writing or take other appropriate action on each appeal submitted, and shall mail or otherwise furnish a copy of the decision to the contractor and the contracting officer.

(f) The rules of each agency board shall include a procedure for the accelerated disposition of any appeal from a decision of a contracting officer where the amount in dispute is $50,000 or less. The accelerated procedure shall be applicable at the sole election of only the contractor. Appeals under the accelerated procedure shall be resolved, whenever possible, within one hundred and eighty days from the date the contractor elects to utilize such procedure.

(g)(1) The decision of an agency board of contract appeals shall be final, except that --

(A) a contractor may appeal such a decision to the United States Court of Appeals for the Federal Circuit within one hundred twenty days after the date of receipt of a copy of such decision, or

(B) the agency head, if he determines that an appeal should be taken, and with the prior approval of the Attorney General, transmits the decision of the board of contract appeals to the United States Court of Appeals for the Federal Circuit for judicial review, under § 1295 of title 28, United States Code, as amended herein, within one hundred and twenty days from the date of the agency's receipt of a copy of the board's decision.

(2) Notwithstanding the provisions of paragraph (1), the decision of the board of contract appeals of the Tennessee Valley Authority shall be final, except that --

(A) a contractor may appeal such a decision to a United States district court pursuant to the provisions of § 1337 of title 28, United States Code within one hundred twenty days after the date of receipt of a copy of such decision, or

(B) The Tennessee Valley Authority may appeal the decision to a United States district court pursuant to the provisions of § 1337 of title 28, United States Code, within one hundred twenty days after the date of the decision in any case.

(h) Pursuant to the authority conferred under the Office of Federal Procurement Policy Act, the Administrator is authorized and directed, as may be necessary or desirable to carry out the provisions of this Act, to issue guidelines with respect to criteria for the establishment, functions, and procedures of the agency boards (except for a board established by the Tennessee Valley Authority).

(i) Within one hundred and twenty days from the date of enactment of this Act, all agency boards, except that of the Tennessee Valley Authority, of three or more full-time members shall develop workload studies.

§ 608. **Small Claims**

(a) The rules of each agency board shall include a procedure for the expedited disposition of any appeal from a decision of a contracting officer where the amount in dispute if $10,000 or less. The small claims procedure shall be applicable at the sole election of the contractor.

(b) The small claims procedure shall provide for simplified rules of procedure to facilitate the decision of any appeal thereunder. Such appeals may be decided by a single member of the agency board with such concurrences as may be provided by rule or regulation.

(c) Appeals under the small claims procedure shall be resolved, whenever possible, within one hundred twenty days from the date on which the contractor elects to utilize such procedure.

(d) A decision against the Government or the contractor reached under the small claims procedure shall be final and conclusive and shall not be set aside except in cases of fraud.

(e) Administrative determinations and final decisions under this § shall have no value as precedent for future cases under this Act.

(f) The Administrator is authorized to review at least every three years, beginning with the third year after the enactment of the Act, the dollar amount defined in § 9(a) as a small claim, and based upon economic indexes selected by the Administrator adjust that level accordingly.

§ 609. **Judicial Review of Board Decisions**

(a)(1) Except as provided in paragraph (2), and in lieu of appealing the decision of the contracting officer under § 6 to an agency board, a contractor may bring an action directly on the claim in the United States Claims Court, notwithstanding any contract provision, regulation, or rule of law to the contrary.

(2) In the case of an action against the Tennessee Valley Authority, the contractor may only bring an action directly on the claim in a United States district court pursuant to § 1337 of title 28, United States Code, notwithstanding any contract provision, regulation, or rule of law to the contrary.

(3) Any action under paragraph (1) or (2) shall be filed within twelve months from the date of the receipt by the contractor of the decision of the contracting officer concerning the claim, and shall proceed *de novo* in accordance with the rules of the appropriate court.

(b) In the event of an appeal by a contractor or the Government from a decision of any agency board pursuant to § 8, notwithstanding any contract provision, regulation, or rules of law to the contrary, the decision of the agency board on any question of law shall not be final or conclusive, but the decision on any question of fact shall be final and conclusive and shall not be set aside unless the decision is fraudulent, or arbitrary, or capricious, or so grossly erroneous as to necessarily imply bad faith, or if such decision is not supported by substantial evidence.

(c) In any appeal by a contractor or the Government from a decision of an agency board pursuant to § 8, the court may render an opinion and judgment and remand the case for further action by the agency board or by the executive agency as appropriate, with such direction as the court considers just and proper.

(d) If two or more suits arising from one contract are filed in the Claims Court and one or more agency boards, for the convenience of parties or witnesses or in the interest of justice, the Claims Court may order the consolidation of such suit in the court or transfer any suits to or among the agency boards

involved.

(e) In any suit filed pursuant to this Act involving two or more claims, counterclaims, cross-claims, or third-party claims, and where a portion of one such claim can be divided for purposes of decision or judgment, and in any such suit where multiple parties are involved, the court, whenever such action is appropriate, may enter a judgment as to one or more but fewer than all of the claims, portions thereof, or parties.

§ 610. **Subpoena, Discovery, and Deposition**

A member of an agency board of contract appeals may administer oaths to witnesses, authorize depositions and discovery proceedings, and require by subpoena the attendance of witnesses, and production of books and papers, for the taking of testimony or evidence by deposition or in the hearing of an appeal by the agency board. In case of contumacy or refusal to obey a subpoena by a person who resides, is found, or transacts business within the jurisdiction of the United States district court, the court, upon application of the agency board through the Attorney General, or upon application by the board of contract appeals of the Tennessee Valley Authority, shall have jurisdiction to issue the person an order requiring him to appear before the agency board or a member thereof, to produce evidence or to give testimony, or both. Any failure of any such person to obey the order of the court may be punished by the court as a contempt thereof.

§ 611. **Interest**

Interest on amounts found due contractors on claims shall be paid to the contractor from the date the contracting officer receives the claim pursuant to § 6(a) from the contractor until payment thereof.

The interest provided for in this section shall be paid at the rate established by the Secretary of the Treasury pursuant to Public Law 92-41 (85 Stat. 97) for the Renegotiation Board.

OFFICE OF THE ASSISTANT SECRETARY
WASHINGTON, D.C. 20310

ARMY CONTRACT ADJUSTMENT BOARD

MEMORANDUM OF DECISION

19 AUG 1980

P.L. 85-804 Application of)
) ACAB No. 1217
Waltham Precision Instruments, Inc.)

Application for Relief

The U.S. Army Armament Materiel Readiness Command (ARRCOM), has forwarded to the Army Contract Adjustment Board a request for extraordinary relief under Public Law 85-804 by Waltham Precision Instruments, Inc. (hereinafter referred to as Waltham) under ARRCOM Contract Number DAAA09-78-C-2080 (hereafter referred to as contract 2080). Waltham seeks an amendment without consideration to increase the price of contract 2080 by $400,000 on the basis of essentiality to the national defense as a continuing source of supply pursuant to the provisions of DAR 17-204.2(a). ARRCOM recommends that relief be granted in the amount of $314,500.00, and the U.S. Army Materiel Development and Readiness Command (DARCOM) concurs with this recommendation.

STATEMENT OF FACTS

Waltham Precision Instruments, Inc., Waltham, Massachusetts, is a small business which primarily manufactures mechanical clocks for aircraft. Contract 2080 was awarded to Waltham on 14 July 1978 for a quantity of 1,873 aircraft clocks at a contract price of $389,584.00. Various options for increased quantities were exercised under the contract resulting in a total current quantity of 4,557. Deliveries of these clocks began in July 1978 and are scheduled to be completed in November of 1980.

Waltham has been a good and reliable producer for the Department of Defense for many years. The company is currently the only active domestic producer of aircraft mechanical clocks using U.S. produced parts. Waltham has been established as a mobilization base producer of critical precision parts.

On 20 December 1978, Waltham filed for a petition under Chapter XI of the Bankruptcy Act before the United States District Court for the District of Massachusetts. The company's situation was the result of operating difficulties which led to losses over the prior three years including operating losses of $238,142 in 1977 and of $246,308 in 1978. During this period Waltham also experienced difficulty in

AMERICAN REVOLUTION BICENTENNIAL 1776-1976

performing on a contract with the Navy for 443 MK-23 fuzes and experienced a loss in excess of $160,000. Nevertheless, Waltham delivered all the fuzes under this Navy contract. Additionally, during this period the company attempted to supplement its clock production by entering the printed circuit business, but experienced losses in excess of $143,000 in this endeavor.

The company's difficulties are attributable to both its own actions and those of the Government. Waltham's business was, and continues to be, primarily the manufacture of clocks for the Government. After the conclusion of a Memorandum of Understanding between the United States and Switzerland, DOD mechanical clock requirements in excess of an estimated quantity necessary to sustain Waltham were opened for competition and awards were made to Swiss firms with whom Waltham was not competitive. The Office of the Secretary of Defense (hereinafter referred to as OSD) determined that a quantity of 300 per month was the minimum sustaining rate for Waltham. This minimum sustaining quantity was subsequently found to be in error because studies indicated that 500 clocks per month must be produced to maintain Waltham as a viable producer. With quantities below the minimum sustaining level and a lack of substantial new business from September, 1976 to April, 1977, the company ran into the financial difficulties described above.

The company's management contributed to the problem with errors in pricing of products and imprudent business ventures. Waltham's accounting system was inadequate and, further, was unacceptable to DCAA for progress payment purposes which precluded such payments. Further, in an effort to increase its share of U.S. Government purchases, the company underbid the current contract for clocks (the loss attributable to contract 2080 is $210,147.50). Additionally, to offset competition from the Swiss in its clock business, Waltham branched out into the manufacture of fuzes and into the printed circuit business. Both these efforts ended in financial disaster.

Faced with Waltham's precarious financial condition, OSD informed the Army on April, 1979 that the Small Business Administration advised that Waltham had cash flow problems and required immediate advance payments to avoid a shut-down of production operations for contract 2080. OSD indicated that it considered Waltham an essential mobilization producer. In June, 1979, advance payment of $150,000 was authorized and contract 2080 was modified accordingly. In its consideration of the advance payment issue, ARRCOM recognized that this would not solve the problem, because more extensive relief under Public Law 85-804 would be required to make the company viable.

Waltham, ARRCOM, DCAS and DCAA have worked together in an attempt to resolve the company's problems. There has been a change in management, and the company's accounting system has now been improved to the satisfaction of DCAA. Additionally, the company has reduced its overhead and G&A rates. Quantities awarded to Waltham have been increased since late 1979 and Waltham has produced profitably at 700 per month for the last two months.

The company has worked out a Plan of Arrangement with its creditors whereby Waltham is to make an initial payment on its debts with run out payments to follow from company profits. The company requests $400,000 in order to fund its Plan of Arrangement to continue as a viable concern. The company projects a $377,000 pretax profit for calendar year 1980 on an estimated production of 8,159 clocks. ARRCOM, supported in part by a DCAA analysis, recommends that the company be provided $314,500 to fund its Plan of Arrangement. This combined amount will enable the company to meet its run out payments and other obligations and provide necessary working capital.

In that Waltham is the only known domestic source capable of making mechanical aircraft clocks utilizing components manufactured exclusively in the United States, both the Air Force and the U.S. Army Troop Support and Aviation Materiel Readiness Command and OSD consider the company essential to the national defense as a continuing source of supply.

DECISION

Based on the information submitted, the Board finds that Waltham is the only domestic producer of mechanical aircraft clocks and that the continued operation of the company as a source of supply of such clocks is essential to the national defense. Additionally, the Board finds that the continued viability of Waltham as a producer of mechanical aircraft clocks will be jeopardized if the Bankruptcy Court orders a liquidation in order to secure payment of long standing debts. Further, the Board finds that extraordinary relief in an amount necessary to fund the Chapter XI Plan of Arrangement will avoid impairment to Waltham's productive ability.

The Board notes, furthermore, that Waltham's financial problems were in part caused by OSD's setting an unrealistic minimum sustaining quantity in order to release clock requirements for competition so as to enable Swiss firms to respond to solicitations. During the course of its discussions with representatives of ARRCOM and Waltham, the Board discovered that the company possesses antiquated equipment and has a total capacity limited to 10,000 clocks a year which is only sufficient for peacetime requirements. In that Waltham is an essential mobilization producer, sufficient quantities should be awarded to the company to maintain it as a viable producer and to allow modernization of its production facility to not only meet peacetime requirements but also mobilization requirements.

Based on the above considerations and pursuant to DAR 17-204.2(a), the Board hereby grants relief in an amount necessary to fund Waltham's Plan of Arrangement and the price of Contract 2080 may be increased accordingly. The grant of relief is conditioned upon and subject to the following:

1. The calculations of the ARRCOM and DCAA audit and pricing personnel are set forth at Appendix A. Notwithstanding Appendix A, the contracting officer may make those minimum payments as he determines necessary to accomplish the purpose of the Board's grant of relief but in no event may the total amount of relief hereby granted exceed $400,000.

2. The funds hereunder granted shall be placed in a controlled account to be administered and paid out by the Contracting Officer in such sums and at such times as he determines shall be in the best interest of the Government to avoid impairment of Waltham's productive ability.

3. Agreement by Waltham to waive any and all existing claims of whatever nature or kind it may have against the Government arising out of or under Contract 2080.

4. Agreement by Waltham to an audit prior to or upon completion of Contract 2080 (the time for the audit to be at the option of the contracting officer).

5. Agreement by Waltham to return any profit on Contract 2080 to the Government.

6. Waltham will pay no cash dividends to its stockholders nor will it provide increases in salary, fringe benefits, pension entitlements or other forms of compensation to any officers or directors until in the opinion of the contracting officer, the company has become viable gain and its productive ability will not be deleteriously affected by such dividends or increases in compensation.

The Contracting Officer is hereby authorized and directed to execute a supplemental agreement consistant with this decision and DAR 17-206.

The action authorized by this decision will facilitate the national defense.

Arthur Daoulas

Arthur Daoulas
Chairman
Army Contract Adjustment Board

1. The following columns list the amount initially requested by Waltham and the amount initially recommended by ARRCOM/DCAA.

	WALTHAM	ARRCOM/DCAA
Unsecured creditors	$ 31,200	$ 26,127
Priority creditors:		
Small Business Adm.	50,000	50,000
Internal Revenue Service	31,200	26,127
Comm'l of Mass.	15,000	15,000
General Services Adm.	13,191	13,065
Commissions	873	219
Pensions	106,459	43,962
Bankruptcy Adm Costs	85,000	65,000
	$332,923	$239,500
Federal Tax	16,850	-
State Tax	36,292	-
Miscellaneous	13,935	-
	$400,000	$239,500

2. The following represents ARRCOM recommended adjustments to the ARRCOM/DCAA recommendation.

Recommended by ARRCOM/DCAA	$239,500
Reconciliation error	10,000
Administrative (additional cost)	20,000
Delay/5 mos @ 5000/mo	25,000
Additional working capital	20,000
Total	$314,500

*U.S.Government Printing Office: 1986 — 646-047/4017

PART 33

PROTESTS, DISPUTES, AND APPEALS

33.000 Scope of part.

This part prescribes policies and procedures for filing protests and for processing contract disputes and appeals.

SUBPART 33.1—PROTESTS

33.101 Definitions.

"Interested party," as used in this subpart, means an actual or prospective offeror whose direct economic interest would be affected by the award of or failure to award a particular contract.

"Protest," as used in this subpart, means a written objection by an interested party to a solicitation by an agency for offers for a proposed contract for the acquisition of supplies or services or a written objection by an interested party to a proposed award or the award of such a contract.

33.102 General.

(a) Contracting officers shall consider all protests, whether submitted before or after award and whether filed directly with the agency, the General Accounting Office (GAO), or for automatic data processing acquisitions under 40 U.S.C. 759 (hereinafter cited as "ADP contracts"), the General Services Board of Contract Appeals (GSBCA). The protestor shall be notified in writing of the final decision of the protest. (See 19.302 for protests of small business status and 22.608-3 for protests involving eligibility under the Walsh-Healey Public Contracts Act.)

(b) An interested party wishing to protest—

(1) Is encouraged to seek resolution within the agency (see 33.103) before filing a protest with the GAO or the GSBCA;

(2) May protest to the GAO in accordance with GAO regulations (4 CFR Part 21). An interested party who has filed a protest regarding an ADP contract with the GAO may not file a protest with the GSBCA with respect to that contract.

(3) May protest to the GSBCA regarding an award of an ADP contract in accordance with GSBCA Rules of Procedure (48 CFR Part 61). An interested party who has filed a protest regarding an ADP contract with GSBCA (40 U.S.C. 759(h)) may not file a protest with the GAO with respect to that contract.

33.103 Protests to the agency.

(a) When a protest is filed only with the agency, an award shall not be made until the matter is resolved unless the contracting officer or other designated official first determines that one of the following applies:

(1) The supplies or services to be contracted for are urgently required.

(2) Delivery or performance will be unduly delayed by failure to make award promptly.

(3) A prompt award will otherwise be advantageous to the Government.

(b)(1) When a protest against the making of an award is received and award will be withheld pending disposition of the protest, the offerors whose offers might become eligible for award should be informed of the protest. If appropriate, those offerors should be requested, before expiration of the time for acceptance of their offer, to extend the time for acceptance in accordance with 14.404-1(d) to avoid the need for resolicitation. In the event of failure to obtain such extensions of offers, consideration should be given to proceeding with award under (a) above.

(2) Protests received after award filed only with the agency shall be handled in accordance with agency procedures. The contracting officer need not suspend contract performance or terminate the awarded contract unless it appears likely that an award may be invalidated and a delay in receiving the supplies or services is not prejudicial to the Government's interest. In this event, the contracting officer should consider seeking a mutual agreement with the contractor to suspend performance on a no-cost basis.

33.104 Protests to GAO.

(a) *General.* (1) A protestor shall furnish a copy of its complete protest to the official or location designated in the solicitation or, in the absence of such a designation, to the contracting officer, no later than one day after the protest is filed with the GAO. Failure to furnish a complete copy of the protest within one day may result in dismissal of the protest by GAO.

(2) When a protest, before or after award, has been lodged with the GAO, the agency shall prepare a report. The report should include a copy of—

(i) The protest;

(ii) The offer submitted by the protesting offeror and a copy of the offer which is being considered for award or which is being protested;

(iii) The solicitation, including the specifications or portions relevant to the protest;

(iv) The abstract of offers or relevant portions;

(v) Any other documents that are relevant to the protest; and

(vi) The contracting officer's signed statement setting forth findings, actions, and recommendations and any additional evidence or information deemed necessary in determining the validity of the

protest. The statement shall be fully responsive to the allegation of the protest. If the contract action or contract performance continues after receipt of the protest, the report will include the determination(s) prescribed in paragraphs (b) or (c) below.

(3) Other persons, including offerors, involved in or affected by the protest shall be given notice of the protest and its basis in appropriate cases, within one work day after its receipt by the agency. The agency shall give immediate notice of the protest to the contractor if the award has been made or, if no award has been made, to all parties who appear to have a reasonable prospect of receiving an award if the protest is denied. These persons shall also be advised that they may submit their views and relevant information directly to the GAO with a copy to the contracting officer within a specified period of time. Normally, the time specified will be 1 week.

(4) The agency shall submit a complete report (see (a)(2) above) to GAO within 25 work days after receipt from GAO of the telephonic notice of such protest, or within 10 work days after receipt from GAO of a determination to use the express option, unless—

(i) The GAO advises the agency that the protest has been dismissed; or

(ii) The agency advises GAO in writing that the specific circumstances of the protest require a longer period and GAO establishes a new date. Any new date shall be documented in the agency's protest file.

(5)(i) Timely action on protests is essential. Upon notice that a protest has been lodged with the GAO, the contracting officer shall immediately begin compiling the information necessary for a report to the GAO. To further expedite processing, when furnishing a copy of the report including relevant documents to the GAO, the agency shall simultaneously furnish a copy of the report including relevant documents to the protestor and a copy of the report without relevant documents to other interested parties who have responded to the notice in (a)(3) above. Upon request the agency shall also provide to any interested party a relevant document contained in the report.

(A) Documents previously furnished to or prepared by a party (e.g., the solicitation or the party's own proposal) need not be furnished to that party.

(B) Classified or privileged information or information that would give a party a competitive advantage and other information that the Government determines under appropriate authority to withhold should be deleted from the copy of the report or relevant documents furnished to that party.

(ii) The protestor and other interested parties shall be requested to furnish a copy of any comments on the report directly to the GAO as well as to the contracting officer.

(6) Agencies shall furnish the GAO with the name, title, and telephone number of one or more officials (in both field and headquarters offices, if desired) whom the GAO may contact regarding protests. Each agency shall be responsible for promptly advising the GAO of any change in the designated officials.

(b) *Protests before award.* (1) When the agency has received notice from GAO of a protest filed directly with GAO, a contract may not be awarded unless authorized, in accordance with agency procedures, by the head of the contracting activity, on a nondelegable basis, upon a written finding that—

(i) Urgent and compelling circumstances which significantly affect the interests of the United States will not permit awaiting the decision of GAO; and

(ii) Award is likely to occur within 30 calendar days of the written finding.

(2) A contract award shall not be authorized until the agency has notified GAO of the above finding.

(3) When a protest against the making of an award is received and award will be withheld pending disposition of the protest, the offerors whose offers might become eligible for award should be informed of the protest. If appropriate, those offerors should be requested, before expiration of the time for acceptance of their offer, to extend the time for acceptance in accordance with 14.404–1(d) to avoid the need for resolicitation. In the event of failure to obtain such extensions of offers, consideration should be given to proceeding under subparagraph (b)(1), above.

(c) *Protests after award.* (1) When the agency receives from GAO, within 10 calendar days after award, a notice of a protest filed directly with GAO, the contracting officer shall immediately suspend performance or terminate the awarded contract, except as provided in paragraphs (c)(2) and (3) below.

(2) In accordance with agency procedures, the head of the contracting activity may, on a nondelegable basis, authorize contract performance, notwithstanding the protest, upon a written finding that—

(i) Contract performance will be in the best interests of the United States; or

(ii) Urgent and compelling circumstances that significantly affect the interests of the United States will not permit waiting for the GAO's decision.

(3) Contract performance shall not be authorized until the agency has notified GAO of the above finding.

(4) When it is decided to suspend performance or terminate the awarded contract, the contracting officer should attempt to negotiate a mutual agreement on a no-cost basis.

(5) When the agency receives notice of a protest filed directly only with the GAO more than 10 calendar days after award of the protested acquisition, the contracting officer need not suspend contract performance or terminate the awarded contract unless the contracting officer believes that an award may be invalidated and a delay in receiving the supplies or services is not prejudicial to the Government's interest.

(d) *Findings and notice.* If the decision is to proceed with contract award, or continue contract performance under (b) or (c) above, the contracting officer shall include the written findings or other required documentation in the file. The contracting officer also shall give written notice of the decision to the protestor and other interested parties.

(e) *GAO decision time.* GAO will issue its recommendation on a protest within 90 work days, or within 45 calendar days under the express option, unless GAO establishes a longer period of time.

(f) *Notice to GAO.* The head of the agency or a designee (not below the level of the head of the contracting activity) responsible for the solicitation, proposed award, or award of the contract shall report to the Comptroller General within 60 days of receipt of the GAO's recommendation if the agency has decided not to comply with the recommendation. The report shall explain the reasons why the GAO's recommendation will not be followed by the agency.

(g) *Award of protest costs.*

(1) GAO may declare an appropriate interested party to be entitled to the costs of—

(i) Filing and pursuing the protest, including reasonable attorneys' fees; and

(ii) Bid and proposal preparation.

(2) Costs awarded under paragraph (g)(1) above shall be paid promptly by the agency out of funds available to or for the use of the agency for the acquisition of supplies or services.

33.105 Protests to GSBCA.

(a)(1) An interested party may protest an ADP acquisition conducted under Section 111 of the Federal Property and Administrative Services Act (40 U.S.C. 759) by filing a protest with the GSBCA. ADP acquisition protests not covered under this statute may not be heard by the GSBCA, but may be heard by the agency, the courts, or GAO. A protestor shall furnish a copy of its complete protest to the official or location designated in the solicitation, or in the absence of such a designation to the contracting officer, on the same day the protest is filed with the GSBCA. Any request for a hearing on either a suspension of procurement authority or on the merits shall be in the protest.

(2) The GSBCA procedures state that—

(i) Within one working day after receipt of a copy of the protest, the agency shall give either oral or written notice of the protest to all parties who were solicited or, if the solicitation has closed, only to those who submitted a sealed bid or offer; and

(ii) Written confirmation of notice and a listing of all persons and agencies receiving notice should be given to the Board within five working days after receipt of the protest.

(b) The GSBCA procedures state that within 10 work days after the filing of a protest, or such longer time as the GSBCA may establish, the agency shall file with the GSBCA and all other parties a protest file. Except where the agency determines under appropriate authority to withhold classified or privileged information or information that would give a competitive advantage, the protest file shall include the following:

(1) A contracting officer's decision, if any.

(2) The contract, if any.

(3) All relevant correspondence.

(4) Affidavits or statements of witnesses on the matter under protest.

(5) All documents relied upon by the contracting officer in taking the action protested.

(6) A copy of the solicitation, the protestor's bid or proposal and, if bid opening has occurred and no contract has been awarded, a copy of any relevant bids and the bid abstract.

(7) In a negotiated acquisition, a copy of offers or proposals being considered for award and relevant to the protest should be included in the GSBCA file only, for *in camera* review by the Board. The agency shall serve all parties with a list of documents provided to the Board for *in camera* review.

(8) Any additional existing evidence or information necessary to determine the merits of the protest.

(9) Any information otherwise withheld, where it is appropriate for *in camera* review by the Board.

(c) The GSBCA procedures state that within 15 work days after the filing of the protest, or such longer time as the Board may establish, the agency shall submit its answer to the Board setting forth its defenses to the protest and its findings, actions, and recommendations in the matter.

(d)(1) If a protest contains a timely request for a suspension of procurement authority, a hearing will be held whenever practicable but no later than 10 calendar days after the filing of the protest. The Board shall suspend the procurement authority unless the agency establishes that—

(i) Absent suspension, the contract award is likely within 30 calendar days; and

(ii) Urgent and compelling circumstances which significantly affect interests of the United States will not permit waiting for the decision.

(2) Circumstances in (d)(1) above shall be established by a D&F executed by the agency head or designee.

(3) The Board's decision on suspension may be oral.

(e) A hearing on the merits, if requested, will be held

within 25 work days after the filing of the protest and a GSBCA decision on the merits will be issued within 45 work days, unless the Board's chairman determines a longer period is required.

(f)(1) The GSBCA may declare an appropriate interested party to be entitled to the costs of—

(i) Filing and pursuing the protest, including reasonable attorney's fees; and

(ii) Bid and proposal preparation.

(2) Costs awarded under (f)(1) above shall be paid promptly by the agency out of funds available to or for the use of the acquisition of supplies or services.

(g) The GSBCA's final decision may be appealed by the agency or by any interested party, including any intervening interested parties, as set forth in Subpart 33.2.

33.106 Solicitation provision and contract clause.

(a) The contracting officer shall insert the provision at 52.233-2, Service of Protest, in solicitations for other than small purchases.

(b) The contracting officer shall insert the clause at 52.233-3, Protest After Award, in all solicitations and contracts. If a cost reimbursement contract is contemplated, the contracting officer shall use the clause with its *Alternate I*.

SUBPART 33.2—DISPUTES AND APPEALS

33.201 Definitions.

"Claim," as used in this subpart, means a written demand or written assertion by one of the contracting parties seeking, as a matter of right, the payment of money in a sum certain, the adjustment or interpretation of contract terms, or other relief arising under or relating to the contract. A claim arising under a contract, unlike a claim relating to that contract, is a claim that can be resolved under a contract clause that provides for the relief sought by the claimant. However, a written demand or written assertion by the contractor seeking the payment of money exceeding $50,000 is not a claim under the Contract Disputes Act of 1978 until certified as required by the Act and 33.207. A voucher, invoice, or other routine request for payment that is not in dispute when submitted is not a claim. The submission may be converted to a claim, by written notice to the contracting officer as provided in 33.206(a), if it is disputed either as to liability or amount or is not acted upon in a reasonable time.

"Misrepresentation of fact," as used in this part, means a false statement of substantive fact, or any conduct which leads to the belief of a substantive fact material to proper understanding of the matter in hand, made with intent to deceive or mislead.

33.202 Contract Disputes Act of 1978.

The Contract Disputes Act of 1978 (41 U.S.C. 601-613) (the Act) establishes procedures and requirements for asserting and resolving claims by or against contractors arising under or relating to a contract subject to the Act. In addition, the Act provides for the payment of interest on contractor claims, for the certification of contractor claims in excess of $50,000, and for a civil penalty for contractor claims that are fraudulent or based on a misrepresentation of fact.

33.203 Applicability.

(a) Except as specified in paragraph (b) below, this part applies to any express or implied contract covered by the Federal Acquisition Regulation.

(b) This subpart does not apply to any contract with (1) a foreign government or agency of that government, or (2) an international organization or a subsidiary body of that organization, if the agency head determines that the application of the Act to the contract would not be in the public interest.

(c) This part applies to all disputes with respect to contracting officer decisions on matters "arising under" or "relating to" a contract. Agency Boards of Contract Appeals (BCA's) authorized under the Act continue to have all of the authority they possessed before the Act with respect to disputes arising under a contract, as well as authority to decide disputes relating to a contract. The clause at 52.233-1, Disputes, recognizes the "all disputes" authority established by the Act and states certain requirements and limitations of the Act for the guidance of contractors and contracting agencies. The clause is not intended to affect the rights and obligations of the parties as provided by the Act or to constrain the authority of the statutory agency BCA's in the handling and deciding of contractor appeals under the Act.

33.204 Policy.

It is the Government's policy to try to resolve all contractual issues by mutual agreement at the contracting officer's level, without litigation. In appropriate circumstances, the contracting officer, before issuing a decision on a claim, should consider the use of informal discussions between the parties by individuals who have not participated substantially in the matter in dispute, to aid in resolving the differences.

33.205 Relationship of the Act to Public Law 85-804.

(a) Requests for relief under Public Law 85-804 (50 U.S.C. 1431-1435) are not claims within the Contract Disputes Act of 1978 or the Disputes clause at 52.233-1, Disputes, and shall be processed under Part 50, Extraordinary Contractual Actions. However, relief formerly available only under Public Law 85-804; i.e., legal entitlement to rescission or reformation for mutual mistake, is now available within the authority of the contracting officer under the Contract Disputes Act of 1978 and the Disputes clause. In case of a question whether the contracting officer has authority to settle or decide specific types of claims, the contracting officer should seek legal advice.

(b) A contractor's allegation that it is entitled to rescission or reformation of its contract in order to correct or mitigate the effect of a mistake shall be treated as a claim under the Act. A contract may be reformed or rescinded by the contracting officer if the contractor would be en-

titled to such remedy or relief under the law of Federal contracts. Due to the complex legal issues likely to be associated with allegations of legal entitlement, contracting officers shall make written decisions, prepared with the advice and assistance of legal counsel, either granting or denying relief in whole or in part.

(c) A claim that is either denied or not approved in its entirety under paragraph (b) above may be cognizable as a request for relief under Public Law 85-804 as implemented by Part 50. However, the claim must first be submitted to the contracting officer for consideration under the Contract Disputes Act of 1978 because the claim is not cognizable under Public Law 85-804, as implemented by Part 50, unless other legal authority in the agency concerned is determined to be lacking or inadequate.

33.206 Initiation of a claim.

(a) Contractor claims shall be submitted in writing to the contracting officer for a decision. The contracting officer shall document the contract file with evidence of the date of receipt of any submission from the contractor deemed to be a claim by the contracting officer.

(b) The contracting officer shall issue a written decision on any Government claim initiated against a contractor.

33.207 Contractor claim certification.

(a) A contractor claim exceeding $50,000 shall be accompanied by a certification that—

(1) The claim is made in good faith;

(2) Supporting data are accurate and complete to the best of the contractor's knowledge and belief; and

(3) The amount requested accurately reflects the contract adjustment for which the contractor believes the Government is liable.

(b) The aggregate amount of both the increased and decreased costs shall be used in determining when the dol-

(The next page is 33-5.)

lar thresholds requiring claim certification are met (see the example in subdivision 15.804-2(a)(1)(ii)).

(c)(1) If the contractor is an individual, the certification shall be executed by that individual.

(2) If the contractor is not an individual, the certification shall be executed by—

(i) A senior company official in charge at the contractor's plant or location involved; or

(ii) An officer or general partner of the contractor having overall responsibility for the conduct of the contractor's affairs.

33.208 Interest on claims.

The Government shall pay interest on a contractor's claim on the amount found due and unpaid from (a) the date the contracting officer receives the claim (properly certified if required by 33.207(a)), or (b) the date payment otherwise would be due, if that date is later, until the date of payment. Simple interest on claims shall be paid at the rate, fixed by the Secretary of the Treasury as provided in the Act, which is applicable to the period during which the contracting officer receives the claim and then at the rate applicable for each 6-month period as fixed by the Treasury Secretary during the pendency of the claim. See 32.614 for the right of the Government to collect interest on its claims against a contractor.

33.209 Suspected fraudulent claims.

If the contractor is unable to support any part of the claim and there is evidence that the inability is attributable to misrepresentation of fact or to fraud on the part of the contractor, the contracting officer shall refer the matter to the agency official responsible for investigating fraud.

33.210 Contracting officer's authority.

Except as provided in this section, contracting officers are authorized, within any specific limitations of their warrants, to decide or settle all claims arising under or relating to a contract subject to the Act. This authorization does not extend to—

(a) A claim or dispute for penalties or forfeitures prescribed by statute or regulation that another Federal agency is specifically authorized to administer, settle, or determine; or

(b) The settlement, compromise, payment, or adjustment of any claim involving fraud.

33.211 Contracting officer's decision.

(a) When a claim by or against a contractor cannot be satisfied or settled by mutual agreement and a decision on the claim is necessary, the contracting officer shall—

(1) Review the facts pertinent to the claim;

(2) Secure assistance from legal and other advisors;

(3) Coordinate with the contract administration office or contracting office, as appropriate; and

(4) Prepare a written decision that shall include a—

(i) Description of the claim or dispute;

(ii) Reference to the pertinent contract terms;

(iii) Statement of the factual areas of agreement and disagreement;

(iv) Statement of the contracting officer's decision, with supporting rationale; and

(v) Paragraph substantially as follows:

This is the final decision of the Contracting Officer. You may appeal this decision to the Board of Contract Appeals. If you decide to appeal, you must, within 90 days from the date you receive this decision, mail or otherwise furnish written notice to the Board of Contract Appeals and provide a copy to the Contracting Officer from whose decision the appeal is taken. The notice shall indicate that an appeal is intended, reference this decision, and identify the contract by number. Instead of appealing to the Board of Contract Appeals, you may bring an action directly in the U.S. Claims Court (except as provided in the Contract Disputes Act of 1978, 41 U.S.C. 603, regarding Maritime Contracts) within 12 months of the date you receive this decision. If you appeal to the Board of Contract Appeals, you may, solely at your election, proceed under the Board's small claims procedure for claims of $10,000 or less or its accelerated procedure for claims of $50,000 or less.

(b) The contracting officer shall furnish a copy of the decision to the contractor by certified mail, return receipt requested, or by any other method that provides evidence of receipt. This requirement shall apply to decisions on claims initiated by or against the contractor.

(c) The contracting officer shall issue the decision within the following statutory time limitations:

(1) For claims of $50,000 or less, 60 days after receiving a written request from the contractor that a decision be rendered within that period, or within a reasonable time after receipt of the claim if the contractor does not make such a request.

(2) For claims over $50,000, 60 days after receiving a certified claim; *provided, however*, that if a decision will not be issued within 60 days, the contracting officer shall notify the contractor, within that period, of the time within which a decision will be issued.

(d) The contracting officer shall issue a decision within a reasonable time, taking into account—

(1) The size and complexity of the claim;

(2) The adequacy of the contractor's supporting data; and

(3) Any other relevant factors.

(e) In the event of undue delay by the contracting officer in rendering a decision on a claim, the contractor may request the agency BCA to direct the contracting officer to issue a decision in a specified time period determined by the BCA.

(f) Any failure of the contracting officer to issue a decision within the required time periods will be deemed a decision by the contracting officer denying the claim and will authorize the contractor to file an

appeal or suit on the claim.

(g) The amount determined payable under the decision, less any portion already paid, should be paid, if otherwise proper, without awaiting contractor action concerning appeal. Such payment shall be without prejudice to the rights of either party.

33.212 Contracting officer's duties upon appeal.

To the extent permitted by any agency procedures controlling contacts with agency BCA personnel, the contracting officer shall provide data, documentation, information, and support as may be required by the agency BCA for use on a pending appeal from the contracting officer's decision.

33.213 Obligation to continue performance.

(a) In general, before passage of the Act, the obligation to continue performance applied only to claims arising under a contract. However, Section 6(b) of the Act authorizes agencies to require a contractor to continue contract performance in accordance with the contracting officer's decision pending final decision on a claim relating to the contract. In recognition of this fact, an alternate paragraph is provided for paragraph (h) of the clause at 52.233-1, Disputes. This paragraph shall be used only as authorized by agency procedures.

(b) In all contracts that include the clause at 52.233-1, Disputes, with its Alternate I, in the event of a dispute not arising under, but relating to, the contract, the contracting officer shall consider providing, through appropriate agency procedures, financing of the continued performance; *provided*, that the Government's interest is properly secured.

33.214 Contract clause.

The contracting officer shall insert the clause at 52.233-1, Disputes, in solicitations and contracts, unless the conditions in 33.203 apply. If it is determined under agency procedures that continued performance is necessary pending resolution of any claim arising under or relating to the contract, the contracting officer shall use the clause with its Alternate I.

PART 33--DISPUTES AND APPEALS

33.013 Obligation to Continue Performance.

(a) The acquisitions of aircraft, naval vessels, missiles, tracked combat vehicles, and related electronic systems shall include the alternate paragraph (h). In addition, the alternate (h) may also be used in those contracts or classes of contracts when it has been determined, in accordance with Department procedures, that it is essential because of unusual circumstances in which the performance of a contract may be so vital to the national security or to the public health and welfare that performance must be guaranteed even in the event of a dispute that may be characterized as a claim relating to, as opposed to arising under, the contract. Examples of the types of unusual circumstances when continued performance may be determined to be vital to the national security or public health and welfare include the acquisition of weapons, support systems, and related components other than those listed above, or other essential supplies or services whose timely reprocurement from other sources would be impracticable. The determination to use the alternate paragraph (h) in other situations shall be made by the head of the contracting activity responsible for the acquisition involved.

33.014 Contract Clause.

The contracting officer may use Alternate I under the conditions set forth in 33.013(a) above.

33.070 Claims for Interest Penalties Under the Prompt Payment Act.

(a) The Prompt Payment Act (Public Law 97-177) provides that a contractor will be paid interest penalties when certain payments by the Government are not made on time or when discounts are taken for payments that are not made within the discount period. The act applies to payments made on contracts awarded on or after 1 October 1982. Under the act, interest penalties are due if the contractor is not paid for delivery of complete items of supplies or services within 15 days after the required payment date (within 3 days for meat or meat food products and within 5 days for perishable agricultural commodities). Interest penalties are also due on the unpaid portion of discount payments made after the discount period. Claims for interest penalties not paid may be made under the Contract Disputes Act.

(b) The required payment date for purposes of the Prompt Payment Act is the date on which payment is due under the terms of the contract or, if a specific date on which payment is due is not established by the contract, 30 days after the later of the date on which a proper invoice is received in the designated paying office or the date on which the supplies or services are accepted. The required payment date for meat and meat food products is not later than the 7th day after delivery, and for perishable agricultural commodities is not

later than the 10th day after delivery, unless another date is specified in the contract. The required payment date for improperly taken discounts is the last day of the discount period.

(c) Interest penalties begin to accrue on the day after the required payment date and end on the date on which payment of the amount due is made. Interest penalties do not continue to accrue under the Prompt Payment Act after the filing of a claim for such penalties under the Contract Disputes Act or for more than one year. Interest penalties also do not accrue under the Prompt Payment Act when payment is not made within the prescribed period after the required payment date because of a dispute over the amount of the payment or other allegations concerning compliance with the contract.

PART 33--DISPUTES AND APPEALS
SUBPART 33.70--CERTIFICATION UNDER SECTION 813 OF PUBLIC LAW 95-485

33.7000 Certification of Requests for Adjustment or Relief Exceeding $100,000.

(a) Section 813 of the 1979 Department of Defense Appropriation Authorization Act, Public Law 95-485, requires the certification of contract claims, requests for equitable adjustment to contract terms, requests for relief under Public Law 85-804, and similar requests exceeding $100,000. This certification must be signed by a senior company official in charge at the plant or location involved. Although the law only requires submission of the certification with requests exceeding $100,000, even if the requirement is not set forth in the contract, the clause contained at 52.233-7000, Certification of Requests for Adjustment or Relief Exceeding $100,000, shall be inserted in all contracts expected to exceed $100,000 in value.

(b) Submission of the Section 813 certification is required in addition to any certification required by the Truth in Negotiations Act and by FAR 15.804-4.

(c) Section 6(c) of the Contract Disputes Act, Public Law 95-563, also requires the certification of claims. The Section 813 certification described above is due when the claim or request for relief is first asserted to the Government. However, the certification under the Contract Disputes Act is due only after a dispute has come into being and the contractor submits a written claim for the purpose of obtaining a contracting officer's decision. A single certification, using the language prescribed by the Contract Disputes Act but signed by a senior company official in charge at the plant or location involved, can be used to comply with both statutes in those situations where the first assertion of a claim or request for relief coincides with the inception of a contract dispute.

(d) In determining when the dollar thresholds requiring a Section 813 certification described above are met, the aggregate amount of both the increased and decreased costs shall be used. (See 15.804-2(a)(1)(ii).)

Chapter K

The purpose of the chapter is to provide Data Source information and information on Ethics, Integrity, and Fraud.

TABLE OF CONTENTS

Topic	Page	Assignment
A. Data Source		
1. Introduction	K-1	Read
2. Data Source Listings	K-2 thru K-3	Read
B. Ethics		
1. Introduction	K-10	Read
2. Code of Ethics	K-11	Read
3. Ethics in The 80s	K-12 thru K-17	Review
4. Ethics and Freedom	K-18 thru K-22	Read
5. Do's and Don'ts	K-23 thru K-35	Review
6. Indicators of Fraud	K-36 thru K-51	Review
7. The New Morality	K-52 thru K-70	Read

SCHOOL ON SYSTEMS AND LOGISTICS

ADVANCED CONTRACT ADMINISTRATION COURSE (PPM 304)

SUBJECT: Contract Data Sources

TIME: 1 Hr

OBJECTIVE: Understand the existence of various sources of information, research, and legal data available to Contract Administration personnel and comprehend how to obtain desired products from each source.

SAMPLES OF BEHAVIOR:

a. Summarize the types of data available from such sources as; FLITE, DTIC and DLSIE.

INSTRUCTIONAL METHODS: Lecture/Discussion

STUDENT INSTRUCTIONAL MATERIALS: ACA Textbook

REQUIRED STUDENT PREPARATION: As defined in chapter "K" of ACA textbook.

SCHOOL ON SYSTEMS AND LOGISTICS

ADVANCED CONTRACT ADMINISTRATION COURSE (PPM 304)

SUBJECT: Ethics

TIME: 2.5 Hrs

OBJECTIVE: Know the government polices governing ethics and standards of conduct.

SAMPLES OF BEHAVIOR:

a. Describe the policies and procedures for avoiding improper business practices and conflicts of interest.

b. Describe the policies and procedures that apply the requirements of the Privacy Act 1974.

INSTRUCTIONAL METHODS: Lecture/Discussion
Case Analysis

STUDENT INSTRUCTIONAL MATERIALS: ACA TEXTBOOK

REQUIRED STUDENT PREPARATION: As defined by Chapter "K" of ACA textbook.

DATA SOURCE LISTING

With the problems associated with the defense dollars, it is important that we be as cost effective as possible in the administration of a government contract.

Today's contract administrator must be able to recognize problems in contract cost schedule and performance. While the contract document references the contract clauses found in the Defense Acquisition Regulations, the contract administrator may be required to look beyond DAR to solve a contract management problem.

As much as we may think today's problems are unique, there may be instances whereby a problem of the 80's may actually have its solution found in the cases of the 70's. At times we reinvent the wheel. This causes dollar losses, schedule slippages and contract non-performance.

How is the contract administrator to know where some of these potential solutions lie? Granted the data information is out there, but how does one get the time to review hundreds or thousands of ASBCA cases, GAO cases Comp. Gen. decisions, or the court determinations?

Perhaps as some possible sources for the contract administrator, a number of agencies have been established to collect some of the information available as a result of modern days, "DATA EXPLOSION." Some of these sources are as close as your telephone. Some are available on a subscription basis. Regardless of where the information comes from, hopefully it will be used to preclude a contract administrator making a mistake on 1980's contract, when there was a solution to that problem in a 1970's case.

The listing of sources of information is provided to you as a starting point. DO NOT stop with this list; add to this list, update this list; be your most valuable contract administration resource. I would be interested in knowing what worked for you.

DATA SOURCE LISTING

A. Federal Legal Information Through Electronics (FLITE)

- FLITE provides cases, legal decisions, statues and regulations relevent to users problem

- FLITE develops and maintains a data base of legal information.

Within a matter of days you can obtain a printout of those ASBCA, Comp. Gen., Court of Claims, etc, decisions which impact the topic you have determined.

- By realizing that the ASBCA has ruled in one or more particular directions may enable you to find solutions to your current contract administration problem.

Autovon 926-7531 Commercial 303-370-7531

B. Defense Technical Information Center (DTIC).

- Providing information on research and development programs, Technical Reports and contract management

- This service provides information as to current studies in a number of technical areas. It is also expanding into the contract management areas and provides information on procurement/administration offices.

Autovon 284-7206 Commercial 202-274-7206

C. Defense Logistics Information Exchange (DLSIE).

- Provides studies under Logistics and Management.

- Current studies as researched by contract study, AFIT study, or other professional military education study are provided by DLSIE.

Autovon 687-4546 Commercial 804-734-4546

D. Commerce Clearing House
4025 W. Peterson Ave
Chicago IL 60646

- This series of volumes provides the background for the Government Defense Acquisition Regulations. This compilation identifies the regulation and provides a court or ASBCA case as background to the regulation. Additionally, an advanced sheet on recent ASBCA decisions is provided.

E. Government Contracts.
Cyclopedic Guide to Law, Administration,
Procedure by John Cosgrove McBride and Isidore H. Wachtel
Published by Matthew Bender
235 E. 45th Street
New York NY 10017

F. Subscription Sources

- These services are provided by a variety of organizations that report on the Washington activity as it pertains to procurement/acquisition. In addition they provide information as to seminars, latest awards, proposed DAR changes, ASBCA cases.

1. Government Purchasing Outlook
   1725 K Street N.W.
   Washington D.C. 20006

   $195/year

2. Federal Contracts Report
   Bureau of National Affairs Inc.
   1231 25th Street N.W.
   Washington D.C. 20037

   $395/year

DATA SOURCES EXERCISE

The purpose of this exercise is to make you aware of the sources of information dealing with contracting. As a practicing professional, it is incumbent upon you to know what sources are collecting the myriad bits of data affecting the contracting arena.

Your task will be to explore some sources of information. Then, on the last day you will brief the class on the topic and the search that was accomplished.

For purposes of this exercise, I will provide you with some topics.

If later in the course you desire to do another search on your own, feel free.

DATA

SOURCE

EXERCISE

PART I

THE PROCESS

As a group, we researched the topic(s): _____

_____

_____

_____

_____

Some key words which we feel may be helpful in obtaining information on that topic include:

_____ _____

_____ _____

_____ _____

_____ _____

_____ _____

Some factors to consider:

- Timeframe - how far back do you want to search?

- Documents - do you want bibliography on general or specific topics?
  - do you want documents?
  - do you want microfiche?

PART II

THE SEARCH

We conducted our search as follows:

We called the following telephone number: _____ and/or _____.

We spoke to _____.

We envision receiving documents such as:

- a bibliography
- textbooks
- microfiche
- computer printout
- references to other data sources

We expect to receive the documents by _____.

PART IV

THE ANALYSIS

After using the _____ search, we can make the following assessment on the topic area of _____.

1. There is no current information available.
2. There is an abundance of information.
3. Other. Explain

The next time I do this search, I will investigate the following:

1. Other areas, such as _____.

2. I will NOT do this search using _____, but instead would use the _____ search.

3. Other comments:

PART III

THE DOCUMENTS

We received the documents on _____. They were/were not what we expected. Explain.

The documents received represent :
- an outline
- actual documents
- other _____

Would there be a further need to obtain more information?

____ Yes, since all we have thus far is a bibliography of sources - we must now order some of those documents.

____ No, we have actual documents we can review.

____ Well, although we have cites, we can now go to those reference documents for further information.

ETHICS

Websters Dictionary gives the definition of ethics as:

1. The rules or standards governing the conduct of the members of a profession.

2. In accordance with the accepted principles of right and wrong that govern the conduct of a profession.

Within government service, civilian and military, are laws and regulations that guide our conduct into ethical channels. The most important of these is the "Code of Conduct" for each service, Army regulation (AR) 600-50, Airforce Regulation (AFR) 30-30, and Navy Regulation (SECNAVINST) 5370-2 addresses what your conduct will be towards civilian contractors and your fellow workers. You must read, or attend class on your regulation twice a year and sign a statement attisting to that. Due to the problems associated with government contracts these regulations have recently changed, so read and understand them instead of just signing the cover sheet and passing the regulation on.

We are deeply concerned with our ethical bearing because of the extremely high incidence of fraud in government contracts. According to the Justice Department, Fraud may total as much as $100 billion a year. We in procurement are the keepers of the publics purse strings because we spend the publics monies. Because of this, there can be no room for poor ethical standards or "The Appearance Of", poor ethical practices or standards. We live and work in a glass fish bowl with all our actions under close scrutiney of the news media. Maintaining sound ethical practices and integrity is the only way to go.

CODE OF ETHICS FOR GOVERNMENT SERVICE—PUBLIC LAW 96-303

Any person in Government service should:

I. Put loyalty to the highest moral principles and to country above loyalty to persons, party, or Government department.

II. Uphold the Constitution, laws, and regulations of the United States and of all governments therein and never be a party to their evasion.

III. Give a full day's labor for a full day's pay; giving earnest effort and best thought to the performance of duties.

IV. Seek to find and employ more efficient and economical ways of getting tasks accomplished.

V. Never discriminate unfairly by the dispensing of special favors or privileges to anyone, whether for remuneration or not; and never accept, for himself or herself or for family members, favors and benefits under circumstances which might be construed by reasonable persons as influencing the performance of governmental duties.

VI. Make no private promises of any kind binding upon the duties of office, since a Government employee has no private word which can be binding on public duty.

VII. Engage in no business with the Government, either directly or indirectly, which is inconsistent with the conscientious performance of governmental duties.

VIII. Never use any information gained confidentially in the performance of government duties as a means for making private profit.

IX. Expose corruption wherever discovered.

X. Uphold these principles, ever conscious that public office is a public trust.

Ethics in the eighties

Issues in Government and Industry

David D. Acker

Ethics—a set of moral principles and values—is receiving a great deal of attention today, and rightly so. Our ethical conduct and values are the key ingredients of character. They enable us to withstand the challenges we have to face daily—the challenges that tempt some of us to compromise our principles.

Some thoughts that might come to mind right away when the subject of ethics is raised are: "What ought I to do?" "How should I act?" "What is meant by 'good'?" "Who is a good person?" "Is there an integrating core or unifying principle that gives cohesiveness and wholeness to the total concept of ethics?"

Editor's Note: This is the first in a series of articles devoted to the author's viewpoints on ethics in the 1980s. The first part provides a background for a common understanding of what ethics is, how it evolved, and how it is practiced successfully. The second part will focus on ethics in management. The third part will address ethics in education.

IMPORTANT PHILOSOPHICAL WORKS ON ETHICS BEFORE THE TWENTIETH CENTURY

Ancient and Medieval

Aristotle, Nichomachean Ethics; Politics.

Plato. The Republic.

St. Thomas Aquinas. Selected Political Writings, ed. A. P. d'Entreves and trans. J.G. Dawson. Oxford: Basil Blackwell, 1948.

Seventeenth Century

Hobbes, Thomas. Leviathan; The Citizen.

Locke, John. Second Treatise of Government.

Eighteenth Century

Bentham, Jeremy. An Introduction to the Principles of Morals and Legislation

Butler, Joseph. Fifteen Sermons Upon Human Nature.

Hume, David. An Enquiry Concerning the Principles of Morals; A Treatise of Human Nature. Book III.

Kant, Immanuel. Foundations of the Metaphysic of Morals.

Nineteenth Century

Mill, John Stuart, On Liberty; Utilitarianism.

Sidgwick, Henry. The Methods of Ethics.

Center for the Study of Ethics in the Professions
Illinois Institute of Technology

Root Meaning

The word "ethics" is derived from the Greek ethos, which referred to a person's fundamental orientation toward life. Originally, the word meant *dwelling place*. Aristotle changed its meaning to *inner dwelling place*, what we recognize as character. The meaning of our English term has shifted from character to actions—to external acts, manner of life, conduct, or habits.

It seems reasonable to assume that the meaning of ethics developed as man reflected on the intentions and consequences of his acts. From such reflections, theories of conscience evolved and they, in turn, gave direction to our ethical thinking today.

For our purpose, let's consider ethics as being concerned with evaluation of human conduct in light of moral principles. We can view moral principles either as the standard of conduct a person has constructed for himself, or as the body of obligations and duties that society requires of him. Patterns of ethical conduct have emerged as man has reflected on the intentions as well as the consequences of his acts.

Early Theories

From reflections on the nature of human behavior, several theories have evolved to provide direction to ethical thought today.[1] The institutionalists of the past—Ralph Cudworth (1617-1688), Frances Hutcheson (1694-1746), and Jean J. Rousseau (1712-1778)—postulated that an innate precept serves as a foundation for ethical decision. The empericists of the past—John Locke (1632-1704), Claude A. Helvetius (1715-1771), and Auguste Comte (1798-1857)—denied any such innate principle. They believed conscience is based upon discrimination that has been acquired by experience. Conscience may be the origination of human behavior or the result of moralizing. Between these extremes, there have been many compromises.

One of the major concerns in any approach to ethics revolves about the question of absolute good as opposed to relative good. Although men have sought an absolute criterion of ethics, moral codes are generally based on religious absolutes.



Moore

George E. Moore's main contribution to ethical theory was his acute discussion of the meaning of basic ethical terms such as "good," "right," and "duty." He argued that ethical values are not basic properties of things and not subjective states of mind.



Dewey

One of the best-known American educators of all times, John Dewey, had an educational theory that emphasized the importance of "learning by doing." He believed that truth is determined on the basis of the consequences of ideas.

Modern Theories

Among modern ethical theories, the following are the most notable:

—**Instrumentalism**, as espoused by John Dewey. This American philosopher and educator believed that morality lies within the individual. According to Dewey, ideas are instruments that function as guides to action, their validity being determined by the success of the action.[1]

—**Emotivism**, as espoused by Alfred J. Ayer. This English philosopher believed that ethical considerations are merely expressions of the subjective desires of the individual.[2]

—**Institutionalism**, as espoused by George E. Moore. This English philosopher and educator postulated that man has an immediate awareness of an act that is morally good.[3]

Albert Schweitzer said that in a general sense, "ethics is the name we give our concern for good behavior." It is the obligation we feel. It is consideration, not only of our own well-being, but of the well-being of others, and even of society as a whole.[4]

Ivan Hill believes ethics to be basic social and working principles. It is more than moral guidelines.[5]

Now let's examine the patterns of ethical conduct.

Ethical Patterns

About a quarter of a century ago, Samuel H. Miller stated that "we have reached the time in our civilization where many different strands of ethical tradition have been woven together.

■ *Mr. Acker is a professor of management in DSMC's Department of Research and Information.*

The pronouns "he," "his," and "him," when used in this article represent both the masculine and feminine genders unless otherwise specifically stated.



Schweitzer

Albert Schweitzer based his philosophy on a "reverence for life" and on a deep feeling of obligation to serve his fellow man through thought and action. He once said, "I...stand and work in the world as one who aims at making men less shallow and morally better by making them think."



Hill

Ivan Hill once said, "The more scientific we become—the more automated—the greater the need for the ethical man, one who is responsible and accountable, who is not only concerned with his own good behavior but with the welfare of others and of mankind as a whole."

Imbedded in the culture which conditions us and our relationships, and imbedded also in us as civilized, educated persons, are several distinctive ethical patterns. These sets of moral attitudes are contradictory enough to be competitive—both in their institutional forms and in their personal aspects." Thus, it would appear that instead of having an impossible ideal confronting a practical necessity, we have such "a confused ethical heritage" that no matter which one we select, the others are betrayed to some extent.[6]

Today, when someone in public life or in society as a whole tries to act ethically, it turns out to be a more difficult task than he might assume. He has to determine which set of ethics to use. He has to make decisions not only between good and bad as he sees it in the popular sense, but between various kinds of goodness. Further, he has to determine the appropriateness of his selection in the specific situation with which he is confronted.

Sometimes the reflective person becomes puzzled about the proper ethical approach in government or business. For example, he might find it too difficult to answer such questions as:

—When does a payment become a payoff?

—When does entertainment become a bribe?

—Where does discretion end and prejudicial discrimination begin?

—How does one shield a financial contribution from the pull of extortion or the push of bribery?

To such questions, we might respond that normal payment, normal entertainment, normal discretion and normal contributions are proper. Then, the questions we have to answer are: "What is normal? What is ethical?"

Layers of Ethics

The concept of ethics has layers of meaning. For our purposes, let's consider what I identify as the common-sense layer, the philosophical layer, the internal layer, and the theological layer. An understanding of each layer can give a better perspective of ethical conduct. For me, ethics includes all of these layers, and they can be combined to form an ethical approach. The progress we make as people generally can be measured by the quality of our acts; however, our primary quality is internal. We might decide to do this and not to do that because common sense leads us to make such a decision, reason commands it, revelation and interpreted religious experience affirms it. We may display ethical behavior in a particular situation in a religiously neutral sense; that is, by using common sense and reason only. However, our ethical conduct reaches its pinnacle when freely and fully developed. When we fully understand the four layers of ethics, we will recognize they are never contradictory.

A closer look at each layer I identified will, hopefully, clarify the point I want to make.

—**Common-Sense Layer.** Everyone has a common-sense detector—a feeling of "what ought to be" or "what ought not to be." We use a display of fairness and rightness when a child cries "That's not fair!" during a game. Yes, even a child experiences moral discontent.

—**Philosophical Layer.** William J. Bryon referred to ethics as a "product of human reason."[7] When viewing ethics philosophically, Bryon believes we find ethics derives principles from reason. He says ethics is aided by reflection on human experience, but not by divine revelation. Ethics is concerned not only with the relationship of the means to an end; it is concerned with the discovery and choice of the most reasonable end. This requires knowledge and practice.

—**Internal Layer.** We tend to judge external acts as either ethical or unethical. We tend to forget that the inner and outer belong together in any ethical consideration. In an ethical crisis, preoccupation with an external violation might impede the discovery of an internal fault. In other words, the emphasis might shift from the person to the action—the external act.



Etzioni

Amitai Etzioni believes basic institutions and traditional values are making a comeback and people are beginning to reshuffle priorities.

—**Theological Layer.** There is a direct relationship between our actions and our religious beliefs. The major role of the theological layer is the ethics of character, the inner self.

Interpersonal Communication

If you stop and think about it, you realize quickly that we use many principles of ethics in interpersonal communications without referring to the legal code. According to John C. Condon, there are eight principles that operate in interpersonal communication:

—**Candor.** "We want *no* to mean *no*. We want disagreement to be expressed directly." We should "encourage openness, trust, and genuine sharing of honest beliefs and feelings."

—**Social Harmony.** "The Japanese avoidance of *no* reflects the value of interdependence over individualism, and social harmony over individual expression." A related adage that many of us will recognize is "if you can't say something good, don't say anything."

—**Fidelity.** "The message received should be as close as possible to the message sent. The message must get through with as little distortion as possible. Feedback from the receiver helps check accuracy and fidelity."

—**Deception.** Exaggeration of information or withholding of information is "a breach of principle."

—**Acknowledgment.** "Is it ethical to ignore a message received by telephone?" Failure to acknowledge a letter received is in some respects more unethical than not responding to a ringing telephone. The letter always identifies the sender; an unanswered ringing telephone does not.

—**Consistency of Word and Action.** "It is not right to deceive another person by telling a deliberate falsehood." Also, it is not right to contradict what we say by taking inconsistent actions.

—**Keeping Confidences and Sharing.** "Secrets or confidences demand choices of loyalties and identification with the discloser, not with anyone else." Is it ethical to encourage another to tell you something in confidence if you promise that it will never be shared with anyone else?

—**Access to Secrets and Invasion of Privacy.** Is it ethical for an organization to gather and maintain information about a person and, then, withhold access to that information from the person to which it pertains?[8]

Ethics in Government and Industry

Ethical issues in government and industry have received unprecedented attention in the past few years. Honesty increases efficiency and productivity in governmental and industrial operations. Big government, like big industry, is no more or less dishonest than small government and small industry. Fortunately, most employees perform in accordance with generally accepted principles of what is right.

Ivan Hill believes that an open society cannot function efficiently, or even be manageable, unless about 80 to 85 percent of the people within that society are honest 80 to 85 percent of the time. When this is not the case, it is likely that such a society will move into authoritarianism; that is, a society that requires absolute obedience to authority—no individual freedom.

What has happened to our traditional values in the United States? Why, until recently, did we show some tendency to retreat from ethical standards? Professor Amitai Etioni believes we have become caught up in excessive individualism. There is a lack of caring and of joining with others for the common good.[10]

The Maintenance of Dignity and Values of Democracy

To have faith in the dignity and worth of the individual man as an end in himself; to believe that it is better to be governed by persuasion rather than by coercion; to believe that fraternal goodwill is more worthy than a selfish and contentious spirit; to believe that in the long run all values are inseparable from the love of truth and the disinterested search for it; to believe that knowledge and the power it confers should be used to promote the welfare and happiness of all men rather than to serve the interests of those individuals and classes whom fortune and intelligence endow with temporary advantage—these are the values which are affirmed by the traditional democratic ideology. But they are older and more universal than democracy and do not depend on it. They have a life of their own apart from any particular social system or type of civilization. They are the values which, since the time of Buddha and Confucius, Solomon and Zoroaster, Plato and Aristotle, Socrates and Jesus, men have commonly employed to measure the advance or the decline of civilization, the values they have celebrated in the saints and sages whom they have agreed to canonize. They are the values that readily lend themselves to rational justification, yet need no justification.

—From Carl L. Becker, *New Liberties for Old Freedom and Responsibility* (New Haven: The Yale University Press, 1941).

Most readers of *Program Manager* work for the federal government and recognize that the government promotes ethics for military and civilian employees. In the early 1980s, the U.S. Congress passed a bill unanimously making it a requirement to display publicly the *United States Code of Ethics for Government Service* in federal buildings (see insert on next page). Today, there are at least 100,000 posted in more than 10,000 public buildings throughout the States.

United States Code of Ethics For Government Service July 1, 1979

Any Person in Government Service Should:

I

Put loyalty to the highest moral principles and to country above loyalty to persons, party, or Government department.

II

Uphold the Constitution, laws, and legal regulations of the United States and of all government therein and never be a party to their evasion.

III

Give a full day's labor for a full day's pay; giving to the performance of his duties his earnest effort and best thought.

IV

Seek to find and employ more efficient and economical ways of getting tasks accomplished.

V

Never discriminate unfairly by the dispensing of special favors or privileges to anyone, whether for remuneration or not; and never accept, for himself or his family, favors or benefits under circumstances which might be construed by reasonable persons as influencing the performance of his governmental duties.

VI

Make no private promises of any kind binding upon the duties of office, since a Government employee has no private word which can be binding on public duty.

VII

Engage in no business with the Government, either directly or indirectly, which is inconsistent with the conscienctious performance of his governmental duties.

VIII

Never use any information coming to him confidentially in the performance of governmental duties as a means for making private profit.

IX

Expose corruption wherever discovered.

X

Uphold these principles, ever conscious that public office is a public trust.

Nonetheless, the government continues to sustain losses due to fraud, waste, and absenteeism. If we assume the code has a positive effect, then such adherence is providing substantial savings annually in government operations.

Challenges Executives Face

Louis W. Norris believes the principal crises of executives are moral in nature. The executive's job rarely is impersonal. His principal problems are what he does about people. The executive may have begun as a master craftsman, production expert, or teacher; but, as an executive, he puts plans into action for people to carry out. Executive actions affect people. The criteria guiding his actions—his morals—are, therefore, an important feature of service as an executive. Norris concludes that the executive is continuously on the radarscope of public judgment.[11]

Among the key tests of an executive are the capacity to accomplish the following:

—Compromise, but not too often

—Make decisions without knowing all the facts

—Accept responsibility for the mistakes of subordinates, but not allow too many

—Live up to the image associates demand, but do not become a victim

—Succeed as a person of thought as well as a person of action.

The standard of success must derive ultimately from moral issues. Some standard of value is expressed in every thought and action. The executive must think and act always in terms of the better alternative.

First, an executive must live with and make compromises. Leadership rests on an amalgamation of opinion—a fusion of standards. A good executive encourages differences and originality of judgment, and is able to choose between present and long-term values. He is able to balance material and non-material values. In the end, executive ideals may actualize into compromise. Unfortunately, compromise disregards universal principles and may lead to undermining of the executive's influence. Further, deviation from principle may become habit-forming. Shortsightedness, mediocrity, or unpredictability can set in when principle is disregarded. Thus, an executive must not fail to evaluate the strength in tension between the values of compromise and adherence to principles.

Second, an executive must recognize the importance of controlling the truth. An executive rarely has the privilege of telling the truth, the whole truth, and nothing but the truth. To illustrate: Truth when told bluntly may hurt a subordinate who is incompetent or misguided. If improvement appears possible for this subordinate, tactful treatment by the executive may involve careful selection of truths that can be told. However, if the executive decides to withhold truth on one occasion, will he do so on others? Can he be trusted to withhold the right truths? No executive tells all he knows as soon as he knows it.

Truth comprises propositions, values, and relations. Only one part of the system can be handled at a time. The question is: How much importance is attached to that part of the whole truth that is made known, and how much is assigned to the remainder that is not made known?

The integrity of an executive is essential. He is trusted with the direction of the organization as long as he is able to relate to its business. He must be able to recognize the whole truth about the organization's operation and handle partial truths called for on each occasion by reference to its part of the whole. A man of integrity is a fully integrated man. He can become so and remain so only by constant regard for the facts he knows—those he discloses and those he does not disclose.

Third, an executive must make a decision sometimes when all of the facts needed are not known, or cannot be obtained. The late Justice of the Supreme Court, Oliver Wendell Holmes, Jr., said, "Genius is the capacity to reach the proper conclusion before all the facts are in." It follows, then, that an executive often is called upon to be a genius. He dare not be wrong, though he may have to trust his judgment; if wrong, the result may be disastrous.

There is an unavoidable loneliness attached to the executive's position. Sometimes an executive vacillates between overconfidence and underconfidence in his own judgment; for example, persistent success can lead to overconfidence, and too many failures can lead to low morale.

Fourth, an executive should like his job because he must be able to handle the issues, however severe. All executive problems have been faced before. A diet of discerning analysis of value like those found in the *Sermon on the Mount*, Aristotle's *Ethics*, and Alfred North Whitehead's *Science and Modern World* provide a perspective and a pathway to solutions.

Fifth, some hazards occur if executives take responsibility for mistakes of a subordinate. Originality and initiative are essential if a subordinate hopes to be successful; responsibility matures the judgment of a subordinate. A moral issue arises when a subordinate's mistakes and failures reach the level when they become expensive or harmful to organizational prestige and colleagues' welfare.

If an executive is to attain success on the job—the kind of which he too can be proud—he must possess a concern for people. The question to answer is, "How far can I go in assuming responsibility for serious errors of my subordinates?" Limits have to be set. A democratic administration depends for success on a common aim individually shared. A democratic executive influences subordinates; therefore, he must set standards of excellence with which subordinates can compare themselves. Subordinates' abilities or inabilities to attain high standards should become so apparent that they will either improve or resign.[12]

Sixth, an executive should lead—not boss. When using rigid discipline, he can meet with resistance, suspicion, hatred, and other negative reactions. The successful executive is a morale builder—engendering a willingness in subordinates to work, to improve, and to cooperate.

Practices Executives Would Eliminate

Practice	Percent
Gifts, gratuities, bribes	23
Price discrimination and unfair pricing	18
Dishonesty in advertising	14
Unfair competitive practices	10
Cheating customers, unfair credit practices, overselling	9
Price collusion by competitors	8
Dishonesty in making or keeping a contract	7
Unfairness to employees; prejudice in hiring	6
Others	5

Influences on Ethical Decisions

Many years ago, a poll determined what influenced an executive regarding ethical decisions. Results, most influential to least influential, were: executive's personal code of behavior, behavior of executive's superiors, formal policy of organization, ethical climate of organization, and behavior of the executive's equals in the organization. On the other hand, another poll determined things influencing an executive to make unethical decisions, resulting in the following: behavior of executive's superiors in the organization, ethical climate of organization, behavior of executive's equals in organization, lack of an organizational policy, and personal financial needs.[13]

From these rankings we learn an executive acts ethically because of a personal set of values and the ability to resist pressure and temptation, giving some credit to superiors and policies of the organization. An executive often acts unethically because of his superior's behavior and the organizational environment.

People are influenced by an executive's behavior, and tend to accept the superior's values. This probably stems from a respect for the position and talents of the superior. Every executive should recognize this tendency as a part of his influence for good or evil; the more subordinates, the more influence. Subordinates expect responsible action to be taken by those invested with power.

Recognizing there are some generally accepted business practices that may be regarded as unethical, the *Harvard Business Review* asked the following question of industry executives: "Are there generally accepted business practices that are unethical?" Eighty percent said there were. The practices executives wanted to eliminate, and the percent identifying particular practices are shown in the chart.

Closing Thoughts

Edmund Burke said "All that is necessary for the forces of evil to win in the world is for enough good men to do nothing."[14] The problem is universal in nature and confronts executives seeing wrong being done in the workplace.

In a recent article, General John A. Wickham, Jr., Army Chief of Staff, summed it up. He observed: "The strength of the Army (and the United States) depends on the quality of our professional and personal values. Values are more than words, they are the key ingredients of character—the stuff we're made of. That character is what enables us to withstand...the challenges that might tempt us to compromise our principles, such as integrity, loyalty, or selflessness....The personal values of competence, courage, commitment, and candor should guide our professional and private lives. When we strengthen these values, we will strengthen our own character, our loyalty to others, and our commitment to a higher calling."[15]

How do you decide the issues you face daily? Do you decide on the basis of preference or principle?■

ETHICS AND FREEDOM

REMARKS BY S. N. MCDONNELL AT THE NCMA 1987 CONFERENCE

5 February 1987

Congress does not trust the Defense Department or the defense contractors. The Defense Department doesn't trust Congress or the defense contractors. And the defense contractors do not trust Congress or the Defense Department. As a matter of fact, the average man in the street doesn't trust anyone or any of America's traditional institutions of the school, the church, business or government.

How did we get in this predicament? In 1748 Baron Charles de Montesquieu published his magnum opus entitled "The Spirit of Laws," which had a profound effect upon our founding fathers. In fact, it was Montesquieu who developed the concept of the separation of powers which, of course, formed the basis of our U. S. Constitution. But he went on to compare the relationship between peoples and various forms of government. A dictatorship depends upon the fear of the people for the government; and when that fear disappears, that form of government is overthrown. A monarchy depends upon the loyalty of the people for the monarch to survive. But the most desirable form of government is a free republic, but it is also the most fragile because it depends upon a virtuous populace. What did he mean by a "virtuous" populace? Virtuous means living by high ethical values. What do we mean by ethics? One of the best definitions that I know of was given by Dr. Albert Schweitzer who said: "In a general sense, ethics is the name that we give to our concern for good behavior. We feel an obligation to consider not only our own personal wellbeing but also that of others and of human society as a whole." Therefore, Montesquieu meant that in a free republic, its leaders and a majority of its people are committed to doing what's best for the nation as a whole. When that commitment breaks down, when the

people of a nation consider only their own personal wellbeing, they can no longer be trusted to behave in the best interest of their nation. The result is laws, regulations, red tape and controls to force them to be trustworthy; and these are all instruments of bondage -- not freedom.

Benjamin Franklin underlined this concept of Montesquieu's when he said, "Only a virtuous people are capable of freedom. The best thing we can do is to teach our young to be virtuous."

Throughout most of our history, certain basic, high ethical values were considered fundamental to the character of our nation and fundamental to the people who made up that nation. These values were passed on from generation to generation in the home, the school and the religious institution -- each one undergirding and reinforcing the others. We had a consensus in this nation not only on values but on the importance of those values; and from that consensus, we knew who we were as a people and where we were going as a nation.

What were those values upon which our freedom was based? They were such things as honor, duty to God and country, service to others, loyalty, kindness, generosity, hard work, self-reliance and above all, honesty and integrity.

But today throughout America far too many homes, schools and religious institutions have fallen down on their traditional roles as protectors and promoters of the ethical values of our American heritage. Today, far too many young people are growing up with almost no exposure to the values that united Americans of all backgrounds -- of all ethnic cultures -- from Canada to Mexico, from the Atlantic to the Pacific.

About 1800, a Professor Alexander Tytler of the University of Edinburgh made the following prophetic statements: "The average age of the world's greatest civilizations has been 200 years. These nations have progressed through this sequence: From bondage to spiritual faith; from spiritual faith

to great courage; from courage to liberty; from liberty to abundance; from abundance to selfishness; from selfishness to complacency; from complacency to apathy; from apathy to dependency; from dependency back again into bondage."

It's interesting to speculate where the U.S.A. is in this cycle. Take selfishness and all the special interest groups that put their own selfish interests above that of the nation, consider complacency and apathy on the part of a large portion of the nation demonstrated by voters who do not turn out at the polls. How about dependency in which that great American virtue of self-reliance has been thrown out the window by far too many people who have their hands out for their "entitlements" from the government. Professor Tytler went on to state: "A democracy cannot exist as a permanent form of government. It can only exist until the voters discover that they can vote themselves largess from the public treasury. From that moment on, the majority always votes for the candidates promising the most benefits from the public treasury, with the result that a democracy always collapses over loose fiscal policy, always followed by a dictatorship." Haven't we done a great job in this country of voting ourselves largess from the public treasury when 45% of our national budget last year went to entitlements?

In large part, America has become a nation of people who are complacent, dependent and put their own selfish interests above that of their nation and their fellow Americans. And our government has responded with an avalanche of laws, regulations, controls and red tape which is wrapping us up like mummies and destroying the freedom that allowed America to become the greatest nation in the world.

That's a rather bleak picture, and what is the answer? I am optimistic because I believe Americans throughout our nation are beginning to realize that the answer is in returning to our traditional values. First of all, we must

once again teach our values in our homes, our schools and our religious institutions.

We in St. Louis are initiating a character education program in the St. Louis public schools next year from kindergarten through the eighth grade. It has been successfully tried in a number of cities like Baltimore, Chicago, Miami and Los Angeles -- and with very encouraging results. The absenteeism has gone down, the vandalism has gone down, discipline has gone up and even academic performance has gone up. The teachers are happier, the community is happier and the students are happier. It's a win-win situation.

The second part of the answer is for us in the adult world to undergird the character education that we prepare for our children by demonstrating to the young people who join us in the adult world that we believe in and practice our traditional American values.

At McDonnell Douglas we adopted a Code of Ethics which, incidentally, was based upon the Scout Oath and Law; and we didn't just hang it on the wall. We realized that we had to teach our employees what we mean by these values, so we initiated a training program in 1984 which began with me, the Chairman of the Board; and so far 33,000 of our 100,000 teammates have received this training. We take every opportunity to underline the basic philosophy that we want our employees to always take the high road. Other companies throughout the country are ahead of us and many more are following us. This same approach must be taken by the news media and the entertainment media -- especially television, the most influential educator of our times; and it obviously must be followed by people in government as well.

You people here today represent a lot of experience, knowledge and expertise, as well as influence in various parts of this nation. I would urge all of you to do what you can to help restore the values of our American heritage to

their rightful place in our nation's daily life. "Only a virtuous people are capable of freedom."

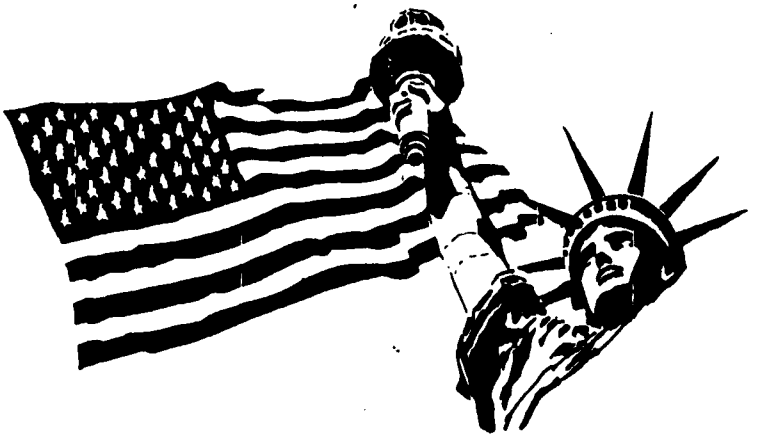
General George Washington once said, "To understand and maintain the American way of life, to honor it by his own exemplary conduct and to pass it intact to future generations is the responsibility of every true American." Let each of us decide how we may discharge our responsibility to these great United States of America.

###

AF PAMPHLET 70-1
24 November 1986

DO'S AND DON'TS OF

AIR FORCE - INDUSTRY RELATIONS



A Few Words on Integrity

The Final Report by the President's Blue Ribbon Commission on Defense Management issued in June 1986 is entitled, A Quest For Excellence. In the foreword to this significant document, the Chairman of the Commission in the concluding paragraph writes, "Defense Contractors and DoD must assume responsibility for improved self-governance to assure the integrity of the contracting process." The responsibility is squarely on each one of us to maintain and demand others to maintain the very highest standards in all our business dealings.

Any lack of integrity in the contracting process is tragic and can be disasterous in its consequences. To do a good job, we in the Air Force are dependent on public confidence - and we must deserve that confidence if we expect public support. One of the specific Commission recommendations is that DoD provide clear, complete and timely guidance to all acquisition organizations and personnel, with regard to ethical issues and standards in the DoD acquisition process. It is within this frame of reference that we have updated and reissued Air Force Pamphlet 70-1, Do's and Don'ts of Air Force Industry Relations. It of course does not cover all eventualities, but it is an attempt to be straightforward and unambiguous as it applies to some specific Standards of Conduct.

When we speak of integrity, what do we mean? There are many good definitions including one in the dictionary which speaks of "adherence to moral and ethical principles." I particulary like one provided by General John D. Ryan, former Air Force Chief of Staff in a speech to the Air War College in May 1973. He said, "to me integrity is the glue that ties us all together - binds us to the national confidence, and makes us an effective fighting force capable of and worthy of defending our great Nation."

I cannot improve on that definition but would like to add that these words apply to all of us, military and civilian alike. All of us in our daily work are responsible for setting a good example. For us in the acquisition community, integrity must never be compromised.

KENNETH V. MEYER
Brigadier General, USAF
Director, Contracting &
Manufacturing Policy

DEPARTMENT OF THE AIR FORCE
Headquarters US Air Force
Washington DC 20330-5000

AF PAMPHLET 70-1

24 November 1986

Contracting and Acquisition

DO'S AND DON'TS OF AIR FORCE-INDUSTRY RELATIONS

In all of our official actions as Air Force personnel, we must constantly be aware that we are the stewards of the American public. It is imperative that in our behavior we try to do the right and proper thing. This means doing our jobs in an equitable, effective, and expeditious manner. To the extent that we uphold the public interest, we will maintain the public confidence.

This publication contains useful guidance particularly with regard to contracting activities. In addition, there is specific guidance to requiring and supporting activities. We must be familiar with the provisions of AFR 30-30, Standards of Conduct, and other regulations that are referenced at the end of this pamphlet. Foremost, we must keep in mind that there is no substitute for the continued application of one's own individual integrity in all relationships. We are all under scrutiny and must strive to be absolutely impartial in our proceedings.

NOTE: This pamphlet is not intended to address all eventualities.

Always do right. This will gratify
some people, and astonish the rest.

-Mark Twain

Section A—For all Air Force Personnel

1. **DO** refrain from any private business or professional activity which places you in a position of conflict between private interests and the public interests of the United States.

2. **DON'T** conduct official business or make recommendations regarding official business with a company or organization in which you or members of your family have a personal financial interest. To do so is a violation of federal law. Report the cir-

---

Supersedes AFP 70-1, 25 February 1970.
No. of Printed Pages: 13
OPR: RDCS (Mr Norman L. Rappaport)
Approved by: Mr Ira Kemp
Writer-Editor: Novella S. Hill
Distribution: F

cumstances immediately to your superior. An officer or employee of the government should not transact official business in a manner or under circumstances which will result in personal gain. (See AFR 30-30.)

3. **DON'T** engage in dealings with military or civilian personnel or former military or civilian personnel if such action will result in a violation of pertinent statutes or policies.

4. **DON'T** solicit, accept, or agree to accept, directly or indirectly, anything of value in return for being influenced in the discharge of official responsibilities.

5. **DON'T** accept, nor permit members of your immediate family to accept a favor, gratuity, or entertainment, directly or indirectly, from industry sources engaged in or endeavoring to engage in procurement or business transactions with Air Force agencies under circumstances other than those permitted under AFR 30-30.

6. **DON'T** engage in private outside employment with or without compensation which interferes with performance of official duties, and may bring discredit on the government or the agency concerned.

7. **DO** use common sense and good judgment where friendships are involved. Such relationships need not be severed because one party is employed by a government contractor and the other by the Air Force. However, one must be prudent at all times. In any exchange of gifts, for example, it must be clear that the gift is not paid for by any source that deals with the Air Force.

8. **DON'T** use your government position to obtain any personal advantages or to obtain for yourself or others, discounts or merchandise in exchange for favors at business establishments.

9. **DON'T** speak lightly or in derogatory terms of the federal laws or Air Force policy regarding the giving and acceptance of gratuities. It is a serious matter, of great concern to the public and to the Air Force, which deserves a serious and dignified attitude from each of us.

10. **DO** remember that in your relations with industry, no body of regulations can cover all possible situations and that there is no final substitute for good individual judgment and integrity of purpose.

11. **DO** report the complete circumstances of possible violations or conflict of interests as required by AFR 30-30.

12. **DO** refrain from expressing a position on the merits of any labor-management dispute between contractors and unions. (See AFR 79-1.)

13. **DO** remember that only contracting officers acting within the scope of their authority under Federal Acquisition Regulation (FAR) 1.602, may enter into contracts on behalf of the government.

14. **DON'T** negotiate for future employment with any contractor that you currently deal with in an official capacity or with any contractor that has a financial interest in any matter in which you are participating, personally or substantially, on behalf of the government.

15. **DO** disqualify yourself, in writing, before engaging in any employment discussions with any entities you do business with (or are likely to do business with) on behalf of the Air Force.

16. **DO** consult your local Judge Advocate General Office when contacts are made regarding future employment with contractors with whom you have dealt in an official capacity.

Section B—For Requiring and Supporting Activities, Before Award

17. **DO** consider procurement and production lead time in computing delivery dates.

18. **DO** provide specific shipping destinations or give firm shipping instructions on purchase requests.

19. **DO** consolidate requirements to permit procurement of similar items for economy in purchasing.

20. **DO** provide names of all known qualified sources with the purchase request.

21. **DON'T** write specifications to obtain a single brand item only.

22. **DO** justify with logic and reason requirements for sole source items when no other product known will meet the minimum need.

23. **DON'T** reject all but one technical proposal when making evaluations without making a documented effort to clearup correctable deficiencies in other proposals.

24. **DON'T** divulge one offeror's technical approach or proprietary information to another offeror.

25. **DON'T** discuss the details of any ongoing source selection solicitation with any industry representative. All questions or communications must be referred to the procuring contracting officer (PCO).

26. **DON'T** discuss the details of government business strategy that might hamper the government's negotiation position.

27. **DON'T** include "brand-name-or-equal" description features peculiar only to one manufacturer's product unless such feature constitutes an essential minimum need.

28. **DON'T** evaluate "brand-name-or-equal" items on the basis of material differences between products unless the purchase description supports the selection of one product over the other. (See Defense Federal Acquisition Regulation 10.004(b)(3)(i)(B).)

29. **DON'T** resort to use of the "brand-name-or-equal" authority in contravention of the provisions of FAR 10.006.

30. **DO** provide complete security classification breakdown of the work to be performed on the DD Form 254, DOD Contract Security Classification Specification.

31. **DO** determine the scope and extent of government-furnished property (GFP) to be provided under the contract and assure its availability through the supply or project office at the time of preparation of the purchase request or specifications. This procedure should help to eliminate one obstacle in meeting the prescribed delivery schedule.

Section C—For Requiring and Supporting Activities, After Award

32. **DO** contact the PCO to discuss and obtain his or her action on any matter relating to contract reductions, extensions, and changes in performance requirements.

33. **DO** notify the Administrative Contracting Officer (ACO) if, during the life of the contract, you become aware of contractor difficulties, either technical or financial.

34. **DO** make engineering problems known immediately to project officers and contracting officers. Remember that delays can be costly.

35. **DO** advise the Contract Administration Office when visits are made to contractors' plants. (See AFR 11-12.)

36. **DO** provide the ACO an information copy of correspondence to contractors whose contracts he or she administers.

37. **DO** be alert to conditions developing which indicate probable cost overruns or underruns and notify the PCO, immediately.

38. **DON'T** tell contractors to ship end items anywhere except as stated in the contract. The PCO will give the contractor shipping instructions so that property will be properly controlled. Emergency requirements may be handled by telephone or other expeditious methods.

39. **DON'T** give any verbal instructions which are outside the scope of the contract or may cause the contractor to incur additional costs.

40. **DO** process DD Form 250, Material Inspection and Receiving Report, promptly. If necessary, request the assistance of the PCO, the ACO, or the property administrator.

41. **DON'T** give the contractor any item of GFP without proper documentation and notice to the ACO and or property administrator assigned the contract.

42. **DO** be prompt in putting delivered items into acceptance tests.

43. **DO** inform the ACO immediately of any discrepancies so that the contractor may be notified and replacement, repairs, or monetary redress made.

44. **DO** assist the ACO in administering the contract. The ACO must rely on supporting activities for technical advice and should be regarded as the captain of the government's contract administration team, whose members come from all supporting activities.

Section D—General Information for Contracting Activities

45. **DO** be familiar with applicable provisions of FAR and Departments of Defense and Air Force supplements. They are sources of vital information, and initial compliance with proper procedures will avoid future delays and difficulties.

46. **DO** keep public interest in the forefront. Encourage competition and participation within industry. Encourage subcontracting in areas of small business. Make every attempt to expeditiously respond to legitimate requests of contractors or prospective suppliers. Remember first and alway—*you are a public servant and a representative of the United States Air Force.*

47. **DO** familiarize yourself with the items that you are called upon to purchase.

48. **DO** process procurements promptly.

49. **DON'T** think solely in quantitative terms. The amount of work done and the timeliness of that work are very important, but so also is the quality of the work, which is often the primary standard by which you, and the Air Force, are judged.

50. **DON'T** conduct business deals with former military or civilian personnel of the government if such action would violate any of the provisions on AFR 30-30.

51. **DO** conduct business with industry in a courteous, efficient, and dignified manner. *You represent the United States Air Force.*

52. **DO** explain to industrial representatives the necessity for government procedures so they will know what is happening to their bids, quotations, proposals, or contracts, and why.

53. **DO** make full use of full and open competition, whenever possible. Remember that full and open competition is the preferred method of procurement.

54. **DO** attempt to determine from the initiating authority the probable future Air Force requirements for the product and request that those requirements be consolidated in order to avoid unnecessary repetitive small procurements.

55. **DO** obtain clarification of purchase requests which appear to exceed normal requirements.

56. **DO** return the request to the initiator if the specification, item description, or statement of work included in the purchase request is not clear; or better still, call the initiator in for clarification and prevent loss of procurement lead time.

57. **DO** use the advice of experts available to you in awarding contracts, e.g., cost and price analysts, engineers, quality control specialists, labor-management relations specialists, legal advisors, auditors, contract administrators, and other technical personnel, as required.

58. **DO** verify bids or quotations where the low price submitted seems to be "out of line" with either the other bids or quotations or previous prices paid for same or similar articles. Endeavor to arrive at a realistic and affordable price which is fair and reasonable.

59. **DON'T** make any commitments to prospective contractors. Don't give information to one source unless you give it to all prospective sources.

60. **DON'T** by your treatment of contractors, allow a reputation to be formed that the Air Force will permit carelessness in contractual relations. For example, mistakes in quotations, slovenly performance, lack of proper documentation, or deceitful business practices cannot be permitted.

61. **DO** document files with adequate memoranda of meetings, telephone conversations, and any other facts or circumstances which may help you to answer questions at a later time regarding contractual actions.

62. **DO** thoroughly review the content of your contract file to assure completion of all actions before submission to the contracting officer or higher authority for approval.

63. **DON'T** assume that reviewing officials have information concerning your procurement over and above that which you furnish.

64. **DO** discourage contractors from starting performance before receipt of a contract authorizing the work. Such work is at the contractor's risk and special procedures should not be relied upon as a means for reimbursement.

65. **DO** require that all orders for work be issued to contractors by authorized contracting personnel. Only the Contracting Officer can bind the government; other personnel may be held personally liable for the results of unauthorized instructions.

66. **DO** report to your Commander, through proper channels, any suspected violation of the public interest discovered in the course of a procurement action. Commanders' responsibilities are prescribed in AFRs 120-3 and 124-8. Report any indications of irregularities or complaints concerning contractors or their representatives to proper authorities.

67. **DO** maintain neutrality in labor-management disputes and coordinate proposed actions with the appropriate Air Force Labor Relations activity.

68. **DO** upon termination or completion of the contract, promptly evaluate contractor performance for future use in a review of past performance.

Section E—Prospective Sources

69. **DO** make awards only to responsible prospective contractors. To be determined responsible, prospective contractors must meet the standards stated in FAR 9.104.

70. **DO** be familiar and comply strictly with regulations relating to mandatory sources, for example, Federal Supply Schedules, or prison and blind-made products.

71. **DO** use solicitation mailing lists established by the contracting activity to assure access to adequate sources of supplies and services as presented in FAR 14.205.

72. **DO** maintain, in addition to your sources file, a systematic record of experience with suppliers.

73. **DO** request and use as appropriate, Pre-award Survey Information as well as reliable private ratings, such as Dun and Bradstreet, Moody's, or Standard & Poor, relative to a company's production and financial capability.

74. **DON'T** contract with firms or individuals whose names appear on the List of Debarred, Ineligible, and Suspended Contractors unless authorization has been obtained as required under FAR Subpart 9.4.

75. **DO** remember that many of your best sources may be small business concerns and ensure that full opportunity is afforded them to participate in the supply of items and services that they are capable of producing or performing.

76. **DO** ensure that firms located in designated labor surplus areas are given the opportunity to participate in Air Force procurements.

77. **DO** endeavor to cultivate new sources in order to expand the list of potential contractors.

Section F—Sealed Bidding

78. **DO** make sure that the Invitation For Bid (IFB) describes the government's requirements accurately and completely.

79. **DON'T** place unnecessary restrictions or limitations in the IFB which will tend to limit competition.

80. **DO** allow a sufficient period of time on IFBs and amendments for a proper response. Consider mailing time and establish a reasonable opening date as required by FAR 14.202-1.

81. **DO** use "pre-invitation notices" as shown in FAR 14.205-4 when there are excessively long bidders' mailing lists.

82. **DO** check all mail processing centers before bid opening to make sure that all bids in Air Force possession are available for public opening.

83. **DON'T** evaluate bids on any basis not provided for in the IFB.

84. **DO** record, and take into consideration, or dispose of late bids according to FAR 14.304.

85. **DO** review all bids for mistakes. Request the bidder to verify the bid and take action under FAR 14.406 where it appears a mistake has been made.

86. **DO** be sure all awards made to other than low bidders are fully justified, in writing, and that the justification is placed in the file.

Section G—Competitive Negotiation

87. DON'T resort to sole source procurement when competition is possible. Make sure of the procurement source files.

88. DON'T use letter contracts or other undefinitized contractual instruments unless absolutely necessary and then only when approved according to FAR 16.603.

89. DO take care that all potential offerors are treated on the same basis. For example, opportunity for time extensions on proposals, revised proposals, or further negotiations must be made available to all.

90. DON'T divulge the name, number of offers, prices, or relative standing of one offeror to another offeror for any purpose.

91. DON'T overlook the value of cost breakdowns and supporting data. Question unrealistic estimates in order that accurate figures will be used for cost comparison and further negotiation.

92. DO seek advice, counsel, and assistance of the Defense Contract Audit Agency, particularly regarding costs and other accounting considerations.

Section H—Regulatory Air Force References

93. AFR 11-7, Air Force Relations With Congress.

94. AFR 11-12, Correspondence With and Visits to Contractor Facilities.

95. AFR 11-26, Gifts to the Department of the Air Force.

96. AFR 11-27, Gifts From Foreign Governments to Members and Civilian Employees of the US Air Force.

97. AFR 30-30, Standards of Conduct.

98. AFR 70-14, Business Strategy Panels

99. AFR 70-15, Source Selection Policy and Procedures.

100. AFR 79-1, Industrial Relations Activities.

101. AFR 120-3, Administrative Inquiries and Investigations.

102. AFR 124-8, Fraud Violations of Public Trust in Contract, Acquisition, and Other Matters.

103. DOD 5200.1R/AFR 205-1, Information Security Program Regulation.

BY ORDER OF THE SECRETARY OF THE AIR FORCE

OFFICIAL

LARRY D. WELCH, General, USAF
Chief of Staff

NORMAND G. LEZY, Colonel, USAF
Director of Administration

*U.S. Government Printing Office : 1986 - 180-976/52162

EXCERPTS FROM THE DEFENSE DEPARTMENT INSPECTOR GENERAL REPORT, "INDICATORS OF FRAUD IN DEPARTMENT OF DEFENSE PROCUREMENT"

* * *

C. Fraud in the Development of Statements of Work and Specifications

Bid specifications and statements of work detailing the types and amounts of goods or services to be provided are prepared to assist in the selection process. They are intended to provide both potential bidders and the selecting officials with a firm basis for making and accepting bids. A well written contract will have specifications, standards and statements of work which make it clear what the Government is entitled to. Sloppy or carelessly written specifications make it easy for a contractor to claim that it is entitled to more money for what the Government later defines as what it really wants. Sometimes, there is deliberate collusion between Government personnel and the contractor to write vague specifications. At other times there is an agreement to amend the contract to increase the price immediately after the award. One contractor actually developed a "cost enhancement plan," identifying all of the changes he would make in order to double the cost of the contract, before it was even signed.

Fraud indicators include:

1. Defining statements of work and specifications to fit the products or capabilities of a single contractor.

2. Advance or selective release by Government employees of information concerning requirements and pending purchases only to preferred contractors.

3. Using statements of work, specifications, or sole source justifications developed by or in consultation with a preferred contractor (institutional conflict of interest).

4. Allowing architect-engineers, design engineers or other firms participating in the preparation of bid packages to obtain those same construction or production contracts or to be subcontractors to the winning contractors.

5. Release of information by firms participating in design and engineering to contractors competing for the prime contract.

6. Designing "pre-qualification" standards or specifications to exclude otherwise qualified contractors or their products.

7. Splitting up requirements so contractors each get a "fair share" and can rotate bids (See Chapter IV).

8. Splitting up requirements to get under small purchase requirements ($25,000) or to avoid prescribed levels of review or approval, e.g., to keep each within the contracting authority of a particular person or activity.

9. Bid specifications or the statement of work are not consistent with the items included in the general requirements.

10. Specifications are so vague that reasonable comparisons of estimates would be difficult.

11. Specifications are not consistent with past similar type procurements.

D. Fraud in Pre-Solicitation Phase

Fraud indicators include:

1. Unnecessary sole source justifications.

2. Falsified statements to justify sole source or negotiated procurement.

3. Justifications for sole source or negotiated procurement signed by officials without authority or the deliberate by-passing of required levels of review.

4. Placing any restrictions in the solicitation documents which would tend to restrict competition.

5. Providing any advance information to contractors or their representatives on a preferential basis by technical or contracting personnel.

E. Fraud in Solicitation Phase

Fraud indicators include:

1. Restricting procurement to exclude or hamper any qualified contractor.

2. Limiting time for submission of bids so only those with advance information have an adequate time to prepare bids or proposals.

3. Revealing any information about procurement to one contractor which is not revealed to all (from either technical or contracting personnel).

4. Conducting bidders conference in a way which invites bid rigging or price fixing or permits improper communications between contractors (See Chapter IV).

5. Failure to assure a sufficient number of potential competitors are aware of the solicitation. (Use of obscure publications, publishing in holiday season, providing a vague or inadequate synopsis to Commerce Business Daily, etc.)

6. Bid solicitation is vague as to the time, place, or other requirements for submitting acceptable bids.

7. Little or no control over the number and destination of bid packages sent to interested bidders.

8. Improper communication with contractors at trade or professional meetings or improper social contact with contractor representatives.

9. Government personnel or their families acquiring stock or a financial interest in a contractor or subcontractor.

10. Government personnel discussing possible employment with a contractor or subcontractor for themselves or a family member.

11. Special assistance to any contractor in preparing his bid or proposal.

12. "Referring" a contractor to a specific subcontractor, expert, or source of supply. (Express or implied that if you use the referred business, you will be more likely to get the contract.)

13. Failure to amend solicitation to include necessary changes or clarifications. (Telling one contractor of changes that can be made after award.)

F. Fraud in the Submission of Bids and Proposals

Fraud indicators include:

1. Improper acceptance of a late bid.

2. Falsification of documents or receipts to get a late bid accepted.

3. Change in a bid after other bidders prices are known. This is sometimes done by mistakes deliberately "planted" in a bid.

4. Withdrawal of the low bidder who may become a subcontractor to the higher bidder who gets the contract.

5. Collusion or bid rigging between bidders.

6. Revealing one bidder's price to another.

7. False certifications by contractor.

   a. Small business certification.
   b. Minority business certification.
   c. Information provided to other agencies to support special status.
   d. Certification of independent price determination.
   e. Buy-American Act certification.

8. Falsification of information concerning contractor qualifications, financial capability, facilities, ownership of equipment and supplies, qualifications of personnel and successful performance of previous jobs, etc.

G. Fraud in the Evaluation of Bids and Proposals

Fraud indicators include:

1. Deliberately discarding or "losing" the bid or proposal of an "outsider" who wants to participate. (May be part of a conspiracy between a Government official and a select contractor or group of contractors.)

2. Improperly disqualifying the bid or proposal of a contractor.

3. Accepting nonresponsive bids from preferred contractors.

4. Seemingly unnecessary contacts with contractor personnel by persons other than the contracting officer during the solicitation, evaluation, and negotiation processes.

5. Any unauthorized release of information to a contractor or other person.

6. Any exercise of favoritism toward a particular contractor during the evaluation process.

7. Using biased evaluation criteria or using biased individuals on the evaluation panel.

II. Fraud in the Award of the Contract

Fraud indicators include:

1. Award of a contract to a contractor who is not the lowest responsible, responsive bidder.

2. Disqualification of any qualified bidder.

3. Allowing a low bidder to withdraw without justification.

4. Failure to forfeit bid bonds when a contractor withdraws improperly.

5. Material changes in the contract shortly after award.

6. Advance information concerning who is going to win a major competition can give advantages to persons trading in the stock of both the winning and losing companies.

7. Awards made to contractors with an apparent history of poor performance.

8. Awards made to the lowest of a very few bidders without readvertising considerations or without adequate publicity.

9. Awards made that include items other than those contained in bid specifications.

10. Awards made without adequate documentation of all preaward and postaward actions including all understandings or oral agreements.

I. Fraud in the Negotiation of a Contract

There are a number of abuses which can occur in the negotiation of a contract. The first stems from the assumption of many personnel that once it has been determined that negotiated procurement procedures can be used (called procurement with discussions in the new FAR), that procurement on a sole source basis has also been justified. Whether a contracting officer is making the decision on a small dollar contract or a formal determination is being made by higher authority, competition is required unless specific justifications exist and are documented.

Fraud indicators include:

1. "Back-dated" or after-the-fact justifications may appear in the contract file or may be signed by persons without the authority to approve noncompetitive procurement.

2. Information given to one contractor which is not given to others which give it a competitive advantage.

3. Improper release of information (e.g., prices in proposals, technical proposals or characteristics of proposals, identity or rank of competing proposals, proprietary data or trade secrets, and Government price estimates) to unauthorized persons.

4. Weakening the Government's negotiating position through disclosures to the contractor selected for award.

5. Contractor misrepresentation as to costs during negotiations (See Chapter III).

6. Failure of Government personnel to obtain and rely upon a Certificate of Current Cost or Pricing Data.

* * *

D. Defective Pricing Indicators

In September 1983, the Director of DCAA issued a memorandum to DCAA auditors stating guidance in the area of defective pricing where certain conditions exist which might indicate fraud. Auditors were instructed that when indications of fraud are found, the case will be referred to the proper investigative agencies. They include:

1. Persistent defective pricing.

2. Repeated defective pricing involving similar patterns or conditions.

3. Failure to correct known system deficiencies.

4. Failure to update cost or pricing data with knowledge that past activity showed that prices have decreased.

5. Specific knowledge, that is not disclosed, regarding significant cost issues that will reduce proposal costs. This may be reflected in revisions in the price of a major subcontract, settlement of union negotiations that result in lower increases on labor rates, etc.

6. Denial by responsible contractor employees of the existence of historical records that are subsequently found.

7. Utilization of unqualified personnel to develop cost or pricing data used in estimating process.

8. Indications of falsification or alteration of supporting data.

9. Distortion of the overhead accounts or base information by the transfer of charges or accounts that have a material impact on Government contracts.

10. Failure to make complete disclosure of data known to responsible contractor personnel.

11. Protracted delay in release of data to the Government to preclude possible price reductions.

12. The employment of people known to have previously perpetuated fraud against the Government.

These indicators should be applied as well by contracting officers and others involved in the procurement process. Particular note should be made in defective pricing cases that the "intent" of the contractor will be critical to a determination of whether a criminal act occured. The deliberate concealment or misrepresentation of a single significant cost element could constitute a prosecutable crime. The establishment of intent should be the function of trained criminal investigators; auditors and contracting officials should make no assumptions that defective pricing results from unintentional conduct.

* * *

C. Indicators of Collusive Bidding and Price Fixing

The following list of indicators is intended to facilitate recognition of those situations which may involve collusive bidding or price fixing. In and of themselves these indicators will not prove that illegal anticompetitive activity is occuring. They are, however, sufficient to warrant referral to appropriate authorities for investigation. Use of indicators such as these to identify possible anticompetitive activity is important because schemes to restrict competition are by their very nature secret and their exact nature is not readily visible.

Practices or events that may evidence collusive bidding or price fixing are:

1. Bidders who are qualified and capable of performing but who fail to bid, with no apparent reason. A situation where fewer competitors than normal submit bids typifies this situation. (This could indicate a deliberate scheme to withhold bids.)

2. Certain contractors always bid against each other or conversely certain contractors do not bid against one another.

3. The successful bidder repeatedly subcontracts work to companies that submitted higher bids or to companies that picked up bid packages and could have bid as prime contractors but did not.

4. Different groups of contractors appear to specialize in Federal, state or local jobs exclusively. (This might indicate a market division by class of customer.)

5. There is an apparent pattern of low bids regularly reoccurring, such as corporation "x" always being the low bidder in a certain geographical area or in a fixed rotation with other bidders.

6. Failure of original bidders to rebid, or an identical ranking of the same bidders upon rebidding, when original bids were rejected as being too far over the Government estimate.

7. A certain company appears to be bidding substantially higher on some bids than on other bids with no logical cost differences to account for the increase, i.e., a local company is bidding higher prices for an item to be delivered locally than for delivery to points farther away.

8. Bidders that ship their product a short distance bid more than those who must incur greater expense by shipping their product long distances.

9. Identical bid amounts on a contract line item by two or more contractors. Some instances of identical line item bids are explainable, as suppliers often quote the same prices to several bidders. But a large number of identical bids on any service-related item should be viewed critically.

10. Bidders frequently change prices at about the same time and to the same extent.

11. Joint venture bids where either contractor could have bid invididually as a prime. (Both had technical capability and production capacity.)

12. Any incidents suggesting direct collusion among competitors, such as the appearance of identical calculation or spelling errors in two or more competitive bids or the submission by one firm of bids for other firms.

13. Competitors regularly socialize or appear to hold meetings, or otherwise get together in the vicinity of procurement offices shortly before bid filing deadlines.

14. Assertions by employees, former employees, or competitors that an agreement to fix bids and prices or otherwise restrain trade exists.

15. Bid prices appear to drop whenever a new or infrequent bidder submits a bid.

16. Competitors exchange any form of price information among themselves. This may result from the existence of an "industry price list" or "price agreement" to which contractors refer in formulating their bids or it may take other subtler forms such as discussions of the "right price."

17. Any reference by bidders to "association price schedules," "industry price schedules," "industry suggested prices," "industry-wide prices" or "market-wide prices."

18. A bidder's justification for a bid price or terms offered because they follow the industry or industry leader's pricing or terms, this may include a reference to following a named competitors pricing or terms.

19. Any statements by a representative of a contractor that his company "does not sell in a particular area" or that "only a particular firm sells in that area."

20. Statements by a bidder that it is not their turn to receive a job or conversely that it is another bidders turn.

D. Collusive Bidding and Price Fixing Examples

The following sections describe common collusive bidding and price fixing schemes which DoD personnel may be able to recognize. These schemes relate to one another and overlap. Frequently an agreement by competitors to rig bids will involve more than one of these schemes.

1. Bid Suppression or Limiting

In this type of scheme one or more competitors agree with at least one other competitor to refrain from bidding or agree to withdraw a previously submitted bid so that a competitor's bid will be accepted. Other forms of this activity involve agreements by competitors to fabricate bid protests or to coerce suppliers and subcontractors not to deal with nonconspirators who submit bids.

2. Complementary Bidding

"Complementary bidding" (also known as "protective" or "shadow" bidding) occurs when competitors submit token bids that are too high to be accepted (or if competitive in price, then on special terms that will not be acceptable). Such bids are not intended to secure the buyer's acceptance, but are merely designed to give the appearance of genuine bidding.

3. Bid Rotation

In "bid rotation," all vendors participating in the scheme submit bids, but by agreement take turns being the low bidder. In its most basic form bid rotation will consist of a cyclical pattern for submitting the low bid on certain contracts. This rotation may not be as obvious as might be expected if it is coupled with a scheme for awarding subcontracts to losing bidders, to take turns according to the size of the contract, or one of the other market division schemes explained below.

4. Market Division

Market division schemes are agreements to refrain from competing in a designated portion of a market. Division of a market for this purpose may be accomplished based on the customer or geographic area involved. The result of such a division is that competing firms will not bid or will submit only complementary bids when a solicitation for bids is made by a customer or in an area not assigned to them.

CHAPTER V: COST MISCHARGING

A. Introduction

Cost mischarging is one of the abuses which is common because of the fact that most large Government research and development and production contracts are cost type contracts. Because the Government reimburses all costs which are allowable, allocable and reasonable, the contractor may increase profit by mischarging. If labor costs are mischarged, they may be multiplied by 100%-300% in indirect cost allowances. Sometimes a contractor is doing similar work for different agencies on fixed priced and cost type contracts. Any work which can be billed to the cost type contracts will be advantageous to the contractor. Sometimes these costs are shifted into indirect cost pools.

Frequently work that is being done by low level technicians is billed as being done by senior scientists or engineers at much higher rates. Some work may be billed to several contracts or indirect cost pools. The Government may be billed for the highest cost items by a contractor and these items may be diverted to its commercial work or the contractor may get "discounts" which are not passed on to the Government or which are applied to its commercial accounts.

The issue as to whether a mischarge was a "mistake" or a crime often depends on the issue of intent. Managers, auditors and contracting officers should not make assumptions about the good faith of a contractor. Investigators should examine the issue of intent. Prosecutors are likely to pursue cases where intent is established even though no substantial loss occurs particularly where the contractor has actively sought to conceal costs.

B. Allowable Costs

Under cost type contracts, the Government reimburses the contractor's costs which are allowable, allocable to the contract and reasonable. These types of contracts include cost plus fixed fee, cost plus incentive fee, cost plus award fee, cost reimbursable and cost sharing contracts. In addition, contract changes and equitable adjustments to contracts are reimbursed on the basis of incurred costs even on fixed price contracts. Cost mischarging occurs whenever the contractor charges the Government for costs which are not allowable, not reasonable, or which cannot be directly or indirectly allocated to the contract.

The DAR 15-205 (FAR 31.205) identifies costs which are allowable and those which cannot be charged to Government contracts. Such costs may be direct costs, such as labor and materials used on one contract and no other, or indirect costs, which contribute to a number of different contracts. Indirect costs are placed in "cost pools" which are then allocated to

contracts on some agreed basis (such as total cost or labor hours).

Unallowable costs include:

1. Advertising costs (except to obtain workers or scarce materials for a contract or to sell surplus or byproduct materials);
2. Bid and proposal costs in excess of a set limit;
3. Stock options and some forms of deferred compensation;
4. Contingencies;
5. Contributions and donations;
6. Entertainment costs;
7. Costs of idle facilities except in limited circumstances;
8. Interest;
9. Losses on other contracts;
10. Long-term leases of property or equipment and leases from related parties are limited to the costs of ownership;
11. Independent research and development costs beyond set limits; and
12. Legal costs related to a contractor's unsuccessful defense against charges of contract fraud.

C. Accounting Mischarges

The fraud most frequently encountered by DCAA auditors is called an accounting mischarge. An accounting mischarge involves knowingly charging unallowable costs to the Government, concealing or misrepresenting them as allowable costs, or hiding them in accounts (such as office supplies) which are not audited closely. Another common variation involves charging types of costs which have their limits (such as bid and proposal costs or independent research and development costs) to other cost categories.

D. Material Cost Mischarges

Material costs are sometimes mischarged. Numerous cases have been discovered where Government owned material was used on a similar commercial contract but the material accountability records showed that the material was used on a Government contract. Also there have been cases where Government owned materials were stolen and the thefts were concealed by showing the materials as being issued to and used on Government contracts. In other situations, materials have been ordered from Government supply depots, but upon receipt the materials were stolen and to conceal the theft entries were made to show that the order was cancelled.

Mischarges of materials are infrequent because the nature of the material items limit their use on other contracts. For example, a gyroscope for a C-130 cannot be used on a KC-135 aircraft. Accordingly, material mischarge are usually limited to raw materials such as aluminum sheets, steel, etc., which can be used on many different contract products.

E. Labor Mischarges

Labor costs are more susceptible to mischarging than material costs because the employees labor can readily be charged to any contract. The only way to assure that labor costs are charged to the correct contract is to actually observe the work of each employee to determine which contract he is working on and then determine from the accounting records that the employee's cost is charged to the proper contract.

Contractors have devised a number of ways to mischarge labor costs. The methods devised range from very crude to very sophisticated. Set forth below are some of the common methods of mischarging.

1. Transfer of Labor Cost

This mischarge is usually made after the contractor realizes that he has suffered a loss on a fixed priced contract. To eliminate the loss, a journal entry is made to remove the labor cost from the fixed priced contract cost and put it on the cost type contract. This type of mischarge is very easy to detect but is difficult to prove. The contractor will contend that the labor charges to the fixed price contract were in error and the journal entry, transferring the cost to the cost type contract, was made to correct that error. Frequently the dollar amount of the transfer is estimated.

2. Time and Charges Do Not Agree with Contractor Billing to the Government

a. This accounting mischarge method is probably the easiest to detect and prove. It is a simple matter of totaling the time and hours expended on the cost type contract and comparing them to the hours billed. For example, the time cards may show that 1,000 hours have been expended on the cost type contract when, in fact, the contractor has billed the Government for 2,000 hours of labor. The difference is obvious and the accounting records (time cards) will not support the billings.

b. Contractor labor billings to the Government are normally supported by two accounting records. The source record is the individual employee time card. The other record is the labor distribution. The labor distribution is usually a computer printout that summarizes by contract the individual time card entries. Usually the contractor will use the labor distribution to support his Government billings. It

is relatively easy to falsify a labor distribution but it is necessary to corrupt the entire work force to falsify the time cards. Hence, the individual time cards should be totaled and reconciled to the labor distribution at least on a test basis.

3. Original Time Cards are Destroyed/Hidden and New Time Cards are Prepared for the Auditor's Benefit

This is a very successful method of concealing a labor mischarge. Mischarges of this nature are very difficult to detect. They are detected when:

a. The hidden time cards are inadvertently given to the auditor.

b. All of the old time cards are not destroyed and the auditor finds them.

c. Employee signature on the time cards are carbon copies because the employee's original signature has been traced.

d. Time card entries are compared to time records maintained by individual employees (copies of time cards, logs, etc.).

4. Changes are Made to Individual Time Cards

A frequent labor fraud encountered by the DCAA auditor is where changes are made to the original contract charge numbers on employee time cards. Some of the charges are so well done that it is difficult to tell that a change has been made. In one instance, the change was made so expertly that the auditor could not tell that a change had been made just from looking at the time sheet. The auditor detected the change by running his finger across the entry and noticed a difference in the "feel." Under magnification, the "white out" material used to cover the original entry could be seen. The auditors used a "light box" to determine what the original charge had been; i.e., by placing a light underneath the time sheet the auditor could read through the "white out" to determine the original charge. Just because changes are made on time cards, it does not necessarily mean that a fraud is being perpetrated. Many times innocent errors are made and corrected. In determining the possibility of fraudulent activity, one should:

a. Determine the magnitude of the changes. If only a few changes have been made then, in all probability, the changes were made to correct errors. However, if a significant percentage of the charges have been changed, the probability of fraudulent activity is increased.

b. A comparison of the original charge number to the revised charge number should be made. If the net effect of the changes is to increase the charges to cost reimbursable contracts, the likelihood of fraud is further increased.

c. Make a review of the sequence of events. For example, in one case the tail number of the aircraft that the employee worked on was posted to the time card in addition to the contract charge number. The following discrepancies were noted:

(1) The original contract charge number corresponded to the contract for which work was to be accomplished on the specified aircraft, whereas, the changed contract charge number was for work on another contract for an entirely different type of aircraft, i.e., the original charge was to the C-130 aircraft and the tail number was a C-130 aircraft, but the new charge was made to the KC-135 aircraft.

(2) Based upon the changed charge numbers, a ridiculous number of employees were working on the same aircraft during the same labor shift.

d. Identify the employee who made the changes, find out why the changes were made and what was the employee's source of information for the changed charge number.

5. Time Card Charges are Made by Supervisors

One should be especially skeptical of timekeeping systems where time card labor charges are posted by supervisors. Management can exert pressure and influence on supervisors to accomplish certain goals. The pressure may influence the supervisor to falsify time charges in order to keep higher level management satisfied with his performance. An even more serious situation occurs when senior level management requires the supervisor to record time charges in a manner most profitable to the company. Management might even go so far as to provide supervisors with "budgets" of how to charge the time for each job. However, if individual employees post their time cards it would be difficult to corrupt the entire work force.

6. Impact of labor mischarges

When a labor cost is mischarged, so is the associated overhead and general and administrative (G&A) expenses. Overhead costs are allocated to labor costs based upon an overhead rate or percentage. Overhead costs usually exceed 100 percent of the labor cost. Therefore, any mischarging on labor rates also impacts upon overhead charges, which ultimately results in a greater than double loss to the Government. The same is true for G&A rates. In computing the dollar amount of the fraud, one must add the overhead and G&A cost because applied overhead and G&A will probably be more than the labor cost involved.

F. Cost Mischarging Examples

1. An overhead audit conducted by DCAA disclosed substantial cost mischarging by a DoD accoustical research contractor. This mischarging principally involved shifting costs on both commercial and DoD contracts to the overhead category and then allocating the overhead to those contracts

(principally DoD) which provided the best overhead rate. A thorough review of the audit work papers disclosed numerous examples of time sheets which had been altered by whiteouts. As a result of the audit and investigation, two senior company vice presidents were found guilty of violations of the Federal conspiracy statute and making false statements. Furthermore, the company was fined $706,000 and ordered to make restitution of approximately $2 million; the two senior vice presidents were fined $20,000 each and given six month sentences.

2. A major DoD contractor was found to have improperly shifted individual research and development costs (IR&D) on to cost type contracts. The corporation was convicted and fined $30,000. An accompanying civil and administrative settlement resulted in the company paying an additional $720,000 to DoD. The corporation also agreed to major revisions in corporate contracting practices and to increased DoD audit access to contractor records. Additionally, $300,000 in legal costs were disallowed.

CHAPTER VI: PRODUCT SUBSTITUTION

A. Introduction

The term product substitution generally refers to attempts by contractors to deliver to the Government goods or services which do not conform to contract requirements, without informing the Government of the deficiency, while seeking reimbursement based upon alleged delivery of conforming products or services. It is the policy of DoD that goods and services acquired must conform to the quality and quantity required in the contract. Goods or services which do not conform in all respects to contractual requirements are to be rejected. It is essential that this policy be strictly adhered to, as failure to do so can result in providing substandard, untested and possibly defective material to our Armed Forces.

When a contract calls for delivery of an item produced by the original equipment manufacturer (OEM), then the contractor must furnish that item. This rule excludes even items that may be identical in all respects but are not produced by the OEM. If the contract requires the delivery of end products produced in the United States, then the contractor is obligated to supply items manufactured in the United States. This is required, even though comparable or identical items are available from foreign sources at lower costs to the contractor. Further, if the contract requires that certain tests be conducted to ensure that an item is suitable for its intended use and can be relied upon to perform as expected, those tests must be conducted. The contractor's ability to produce an item that will perform within acceptable limits regardless of whether actually tested is not relevant.

Contractors frequently argue that substituted goods or services delivered to the Government were "just as good" as what was contracted for even if specifications are not met, and that, therefore, no harm is done to the Government. There are several important fallacies to be noted when considering this argument. First and foremost, the substitute is usually not as good as what was contracted for. In cases of product substitution investigated to date, the substitute is usually one of inferior quality or the workmanship is extremely poor because it was done by lesser qualified, and cheaper labor. Secondly, while the immediate harm that the substitute might cause or may have in fact caused is sometimes difficult to determine, its introduction into Defense supply channels undermines the reliability of the entire supply system. If, for example, a microchip were in use in larger components which failed, the cause of the failure might not be directly traceable to the inferior quality of the microchip. Third, even if the item is as good, there is harm to the integrity of the competitive procurement system which is based upon all competitors offering to furnish the item precisely described in the specifications.

B. Fraud Potential

There are a wide variety of fraudulent schemes that may involve what is termed product substitution. Many of the recent product substitution fraud allegations involve consumable or off-the-shelf items. DoD employees should be aware of similar problems which have arisen in component parts and materials used in weapon systems, ships, aircraft and vehicles. Cases have included:

1. the nondelivery of supplies paid for pursuant to fast pay procedures;

2. the delivery of look-alike goods made from nonspecification materials;

3. materials that have not been tested as required by the contract specifications; and

4. providing foreign made products where domestic were required.

Product substitution cases sometimes involve Government employees. For example, gratuities and bribes have been paid to Government inspection personnel to accept items which do not conform to contract requirements.

The potential for a product substitution case is greatest where DoD relies upon contractor integrity to ensure that the Government gets what it has paid for. For example, fast pay procedures apply to small purchases. The Government pays contractors for goods based on certification of shipment. Quality assurance is frequently limited in scope, and is performed after payment has been made. Thus, small purchases such as these are particularly susceptible to unscrupulous contractors.

In large dollar value procurements, Government quality personnel often rely upon testing performed by the contractor. Falsification of the test documents may conceal the fact that a piece of equipment has not passed all the tests required by contract or has not been tested at all. False entries may also conceal the substitution of inferior or substandard materials in a product. When Government personnel actually witness or

9-10-84 Published by THE BUREAU OF NATIONAL AFFAIRS, INC. Washington D.C. 20037

perform tests themselves, there is always the possibility that what they are seeing is a specifically prepared sample not representative of the contractor's actual production.

C. Product Substitution Examples

1. A contractor allegedly employed two methods to bypass the Government inspection process to conceal intentional inclusion of substandard defective aircraft parts. The contractor would allow random unscheduled inspections of products prior to shipment and then substitute defective parts into the already inspected shipment. The second method was to ship the parts, including defectives, directly to distribution points before inspection took place.

2. A contractor was required to provide metal of specified type and grade for use in aircraft struts, ballast shields and bulkheads in ships. The contractor would purchase an inferior grade of required metal types or different types of metal entirely. False invoices and test results were created showing the required metals were being provided. The true specification stenciling was removed from the substituted metals and the required specifications stenciled on.

3. A contractor combined several schemes to conceal the production of substandard goods. Each of the schemes was aimed specifically at overcoming Government conducted quality assurance inspections (QAI). The contractor would: surreptitiously enter a locked area and substitute specially created samples for those the QAI personnel selected; move inspection tags to uninspected substandard goods after inspectors left; remove part of the good materials after inspection and add substandard or previously rejected materials; and disguise the true condition of substandard goods with chemicals the known inspection process would not disclose. Some of these tactics might have been neutralized by: unscheduled initial and repeat inspections; using inspection tags which would void automatically if moved; and requiring proof of or observing disposal of rejected goods.

4. A contractor was to provide instrument kits that were to be manufactured in the United States. Some of the materials were to be purchased from foreign sources, in compliance with the Buy American Act. The contractor showed the Quality Assurance Representative (QAR) raw forgings from which the instruments were to be made. The contractor then bought completed products from foreign sources. The markings of the country of origin were removed and the instruments marked showing United States manufacture. This scheme was not discovered by post production review by QAR personnel who random sampled the finished instruments. There were thousands of kits each containing 40 instruments, only some of which were altered. Users later found the original country of origin still on some items and obvious alterations on others. User complaints to quality assurance personnel led to specific inspections and discovery.

5. Two contractors, in separate cases, were required by their contracts to supply products that were domestically manufactured. In both instances, the contractors provided false documents establishing the purchase of raw materials in accordance with the contract requirements. Both contractors were in fact buying, in violation of Buy American provisions, finished products from foreign sources that manufactured them. One of the contractors also provided falsified test data to prove the product met specifications. The QAR in both cases suspected irregularities and made further inquiries which led to investigative referrals.

6. A contractor was required to provide parachute cord which would withstand certain strength tests. These tests were to be performed by a private laboratory. It was discovered that for six years the contractor had provided the Government with substandard cord and had covered up its conduct by giving the Government forged laboratory reports. Subsequent laboratory examination showed that the cord was over 25 years old and was completely inadequate. Immediate steps were required to remove all cord provided by this company from DoD inventories.

CHAPTER VII: PROGRESS PAYMENT FRAUD

A. Introduction

Progress payments are payments made as work progresses under a contract based upon the costs incurred, the percentage of work accomplished, or the attainment of a particular stage of completion. They do not include payments for partial deliveries accepted by the Government.

Fraud in progress payments occurs when a contractor submits a progress payment request based on falsified direct labor charges, on material costs for items not actually purchased, or on falsified certification of a stage of completion attained/work accomplished.

When a DoD contract contains one of the contract clauses in DAR 7-104.35 (FAR 52.232.16), a contractor may submit monthly progress payment requests and is entitled to receive a contractually specified percentage (95 percent if the contractor is a small business concern, 90 percent if the contractor is not small) of its "total costs." There are two definitions for "total costs," one for small businesses and the other for concerns which are not small. These costs include direct and indirect labor as well as material costs. For our limited purposes, the only significant difference between the two definitions concerns material costs--a concern that is not small must have actually paid for the materials for which the Government is being billed, while a small business need only have incurred an obligation to pay for the materials (although it must have acquired title to the materials).

Requests for progress payments are made on DD Form 1195. On this form the contractor identifies its contract costs and certifies that the statement of costs has been prepared from the contractor's books and records and is correct. In addition the contractor also makes a certification concerning encumbrances against the materials acquired for the contract.

The purpose of progress payments is to provide contractors with a continuing source of revenue throughout contract performance and to ensure that a contractor will have the necessary financial resources to meet its contractual obligations. Although some progress payment requests are audited before payment, for the most part DoD relies solely upon a contractor's integrity in making these payments. When a contractor requests payments for costs not actually incurred, the Government is harmed in many ways: (1) the contractor has the interest free use of money to which it is not entitled and which the Government itself may have had to borrow from the public; (2) the Government may lose its advances if the contractor goes out of business and there are no materials or completed products against which the Government may assert an interest; and (3) honest contractors lose their faith in the system and others, who are less scrupulous, are encouraged to take advantage of the system.

B. Progress Payment Fraud Indicators

Firms with cash flow problems are the most likely to request funds in advance of being entitled to them. Progress payments which do not appear to coincide with the contractor's plan and capability to perform the contract are suspicious. This could indicate the contractor is claiming payment for work not yet done.

Another type of contractor fraud in this area is to submit a progress payment claim for materials which have not been purchased. The contractor may be issuing a check to the supplier, then holding it until the Government progress payment arrives. One way to confirm this irregularity is to check the cancellation dates on the contractors checks. If the bank received the check about the same time or later than the contractor received the progress payment, the check was probably held.

C. Progress Payment Fraud Examples

1. A contractor, entered into an agreement with a Military Service to supply and install computer controlled material handling systems at various installations located throughout the United States. The contractor then entered into an agreement with a subcontractor to locate and procure computers and computer equipment in order to satisfy the requirements of the contract. The contractor agreed with the subcontractor to provide false invoices for computers and computer equipment, which would be claimed and billed to DoD in progress payment requests. The contractor would receive payments from DoD and purported to pay the subcontractor based on false invoices. The subcontractor then returned the money to the contractor in the form of cashiers' checks

2. A contractor conducted environmental impact studies for DoD as well as local governments and private concerns. The contractor directed employees to charge idle time and time from local government or private contracts against the DoD contracts thereby creating false documents to support requests for progress payments. In addition, the contractor directed employees to create overtime work and billed for noncompensated overtime worked by salaried employees so that funds allocated for labor costs could be "burned up." This overtime work did not relate to work on the DoD contracts and resulted in a $300,000 loss to DoD.

3. A contractor submitted false work reports which resulted in progress payments of $69,000 for work not actually performed on a $6.3 million contract to repair and renovate a sewage treatment plant. The fraud was discovered during performance of the contract due to a malfunction of the system. In correcting the malfunction it was discovered that sewer pipes had not been cleared or lined as required by specifications and reflected in the contractor's work reports.

CHAPTER VIII: FAST PAY FRAUD

A. Introduction

There are specific DoD regulations regarding fast pay. In general, the fast pay procedure is limited to contract orders that do not exceed $25,000. The fast payment procedure spelled out in DAR 3-606 (FAR 13.3) is designed to reduce delivery times and to improve DoD's relations with its suppliers by expediting contract payments. The procedure provides for payment based on the contractor's submission of an invoice. That invoice is a representation by the contractor that the supplies have been delivered to a post office, common carrier or point of first receipt.

Fraud in fast pay occurs when a contractor submits an invoice requesting payment for supplies which have not been shipped or delivered to the Government. If the supplies are not in transit or actually delivered at the time the contractor submits his invoice, a criminal violation has occurred. It does not matter if the supplies are subsequently delivered to the Government.

There are specific DoD regulations regarding fast pay. In general, the fast pay procedure is limited to contract orders that do not exceed $25,000. Fast pay orders are usually issued on the DD Form 1155. Regardless of the contract form used for the fast pay purchase, the contract will contain the following certification clause: "The Contractor agrees that the submission of an invoice to the Government for payment is a certification that the supplies for which the Government is being billed have been shipped or delivered in accordance with shipping instructions issued by the ordering officer, in the quantities shown on the invoice, and that such supplies are in the quantity and of the quality designated by the cited purchase order."

The fast pay procedure benefits both the contracting community and DoD. However, contractor integrity and honesty is essential. Payments are made before DoD is in a position to verify that it has received what it bargained for. In many cases, especially where overseas deliveries are involved, it may be weeks or even months before the DoD activity which actually issued the fast pay order is advised of either a nonconforming delivery or a nonreceipt. By that time an unscrupulous contractor may have had an opportunity to bilk the Government out of thousands of dollars and to drop out of

3-10-84 Published by THE BUREAU OF NATIONAL AFFAIRS, INC. Washington D.C. 20037

sight. Because of the potential for large losses and the effect that such losses could have on continued use of the fast pay procedure, immediate detection of those who have abused the system is necessary.

B. Fast Pay Fraud Indicators

How can DoD personnel dealing with fast pay identify possible fraud? The most obvious, and sometimes most difficult thing to do, is check for the correlation between the claim for payment and the delivery of goods. Since the claim for payment and receipt of goods occur at different locations this will require communication between paying and receiving points. An employee who becomes suspicious should check with the receiving point to verify that the goods have arrived. Some important things to check for include: not receiving the goods at all, receiving the goods later than would be expected if they were mailed when claimed, and receiving nonconforming goods. The latter sometimes occurs because the contractor has lost the incentive to perform fully to contract specifications after he has been paid.

DoD personnel should also be alert for indications that the invoice submitted by the contractor is forged or altered in some way to make it appear that the goods were sent. Information on the invoice may raise questions such as shipment on a weekend or holiday.

C. Fast Pay Fraud Example

A contractor entered into an agreement with DoD for the supply of electrical cable protector and other electrical items under the fast payment procedure. The contractor submitted false invoices totaling $32,573.42 claiming goods had been mailed. The contractor was fully aware that this was not the case since its supplier had refused to honor any more purchase orders from the contractor for goods to be shipped to the Government.

CHAPTER IX: BRIBERY, GRATUITIES and CONFLICTS OF INTEREST

A. Introduction

This chapter is dedicated to the discussion of integrity awareness. It will inform managers and employees about their responsibilities to be alert for bribe offers, to avoid the acceptance of gratuities, and to recognize conflicts of interest. It calls attention to the relationship and impact of these issues on the procurement process. Further, the chapter discusses the existence and significance to the procurement process of bribery and kickbacks between non-Government entities, e.g., prime contractors and subcontractors.

B. Bribery

In addition to being a crime, as discussed below, the use of bribery and gratuities in obtaining or doing business changes the nature of the Government's relationship with a contractor or potential contractor. It certainly bears upon the issue of contractor responsibility and possibly the retention of security clearances. How much reliability can be placed in later assertions made by someone who has attempted to bribe a Government employee or an employee of another firm? How can, in good conscience, such a person/company be certified as having the necessary business integrity to be a responsible bidder? It should be remembered that contractors using such methods to do business are usually doing so with the intent to further some form of procurement fraud they are committing or trying to commit. The Government should avoid business with contractors who must resort to kickbacks or bribery to obtain contracts. Where DoD must continue to do business with a contractor due to the circumstances of the procurement, e.g., unique product, stage of development or production of a major system, necessary actions such as increased inspection, review and audit activities should be considered to protect the Government's interests.

1. Manager Responsibilities

Managers have many responsibilities in the area of integrity awareness. They must set examples, not only of personal integrity and high ethical standards, but also of a willingness to participate in the referral and investigation process. Too often employees are discouraged from paying attention to or reporting possible bribe situations because it is thought that subsequent actions are time-consuming and disliked by managers because of the work involved. Instead of giving any impressions that they are unsympathetic to this process, managers should actively encourage their employees to be acutely aware of potential bribe overtures, encourage their employees to report bribe attempts immediately and indicate to their employees that they will have full support from management in any efforts to assist investigators in obtaining evidence of the offense.

The tendency to treat less blatant attempts at bribery as ordinary occupational hazards or as routine innuendos which can easily be ignored or dismissed is another reason that many bribes are not reported. Another reason might include the sentiment that refusal of a bribe offer is deterrent enough. It is part of a manager's job to ensure that these conditions are not impediments to rapid, timely, and efficient reporting of attempted bribes.

2. Employee Responsibilities

There are some primary areas that should be focused on in discussing bribery awareness with employees. These areas of concern can be grouped into several questions.

a. What constitutes a bribe? A bribe is an offer to employees of something of value to (a) do something they should not do or (b) fail to do something they should do, in their official duties. The something of value need not be money, it can be anything of value.

b. When is a bribe being offered? People who offer bribes are generally astute and aware individuals. A blatant offer is a rarity. Generally, the party offering a

bribe will make subtle overtures in a conventional fashion. They may begin by discussing the employee's life style, family, or salary. They are looking for a vulnerable area where they can exploit the employee. They may seek to establish that the employee has college age children and begin discussing the high cost of education. They may learn that the employee is a new homeowner and discuss high mortgage payments and the expenses of fixing up a new home. If unable to detect an area in which the employee is particularly vulnerable, they may move to more glamorous and alluring areas; cash, cars, and travel. In summary, if the employee feels that the individual is getting beyond mere civility and the professional purpose for the meeting, the employee should be alert to the possibility of a bribe attempt.

The preliminary conversation may be an attempt to feel the employee out. The person attempting the bribe knows that bribe offers are illegal. They also know that a strong employee has an obligation to report the attempted bribe. Most importantly, the offeror of the bribe does not want to get caught. If the employee is not receptive to subtle overtures and alternative attempts fail, the person may not make any overt bribe offer. An employee has an obligation to determine the nature of the person's remarks. The very subtlety of these preliminary overtures makes the employee's job of detecting a bribe a delicate one.

c. What should be done if a bribe is offered? The first goal is to establish the nature of the person's remarks. Once the attempt to bribe has been determined, the employee should deftly negotiate out of the situation in order to report the attempt immediately to the appropriate investigative organization. An employee who firmly rejects the offer and then reports the attempt will only be faced with a later denial from the offeror. It is essential that an investigator be involved immediately. Employees may use any of several noncommittal excuses to extricate themselves from the meeting without closing out whatever business was the subject of the meeting. Further, the door should be left open for future contact with the offeror.

The response to the offer must be noncommittal. This allows the employee to break off the contact and return with an answer later so that the later meeting can be monitored by an investigator. It can be more difficult for the employee to be noncommittal if the offer is very blatant and direct.

A noncommittal answer like those suggested below might be appropriate where a direct or blatant offer is involved:

- "I don't know, I've never done anything like this, I need to think about it."

- "I really need to look at some more information first, let me think about it."

- "I have to think about that carefully."

- "First I need to figure out what's involved here and then I'll get back to you."

After termination of the conversation, immediately contact the appropriate investigative organization and report the attempt.

d. Why not accept a bribe? The clear answer to this question is that the acceptance of a bribe is a criminal act which can result in prosecution, dismissal, fines and embarrassment to the family and friends of the employee. Is anyone's future and family worth the small amount they may receive, no matter how much the amount may seem at the time?

In addition, accepting a bribe leaves one always at the mercy of the person who paid it. There is no such thing as a one-time favor for one who accepts a bribe. Since the employee has committed a crime, the briber can ask anything later on under the threat of reporting the bribe, claiming it was solicited and threatening exposure.

e. Why not just refuse a bribe without reporting it? When an employee rejects a bribe, the offeror of the bribe may become concerned that the employee will report the attempt. They may decide that the best way to deal with the situation is to report that the employee tried to solicit a bribe and offer to cooperate in having the employee prosecuted or dismissed for it. If the employee has not reported the attempt, it would give credence to the offeror's allegation. Even though the employee has done nothing wrong, the allegation would have to be investigated and could cause undue problems and time to resolve.

Furthermore, since the attempt to bribe a Government official is in itself a crime, failure to report an attempted bribe, as well as other crimes, leaves the employee open to possible prosecution.

The failure to report a bribe attempt also leaves the offeror free to try again with another employee of the Government. The next employee may not be able to resist the offer. Further, there is no deterrent effect in refusal of the attempt. The offeror is free to try again without fear of the potential consequences. Investigation and prosecution of those who would try to corrupt our employees and our system of Government is the only way to deter others from believing that this is the way to do business with DoD.

3. Bribes Are A Reality

As a demonstration that the foregoing discussion relates to a very real problem, here are a few examples of recent DoD bribery cases.

a. A Navy commander accepted several thousand dollars in money and goods to ensure the Government made purchases from a particular company.

b. A DoD civilian employee accepted almost $90,000 over four years to make sure a specific company was awarded contracts.

c. A corporate sales manager was sentenced to ten years in prison, fined $1,000 and ordered to make nearly $10,000 in restitution after conviction on multiple charges of bribing a DoD civilian employee relating to a scheme of false and inflated billings.

d. A member of a corporate board of directors was sentenced to 30 days confinement and fined $1,000 after being convicted of conspiracy to bribe a civilian employee of DoD.

e. A DoD civilian employee received a two year prison sentence for accepting over $17,000 for steering contracts to a favored corporation.

f. A civilian quality assurance inspector was convicted of receiving over $2,000 from a contractor for accepting substandard goods.

g. A GS-4 file clerk was convicted of receiving approximately $50,000 in bribes from various contractors to provide them inside information used to enhance their bid packages.

4. Commercial bribery and kickbacks

There are times when payments of bribes and kickbacks do not involve Government employees but still impact on the procurement process. Employees or officers of a prime contractor may solicit or be offered and accept payment of bribes or kickbacks in connection with the award or performance of subcontractors. Subcontractors may initiate such payments to prime contractor employees to obtain competitors' bid or technical data to gain an unfair competitive advantage. Such activities may impact on the procurement process in several ways. The price paid for the product or service may be higher because the subcontractor passes the cost of bribes and kickbacks through to the prime. In extreme instances, the kickbacks may be so significant that the subcontractor cannot perform the work in conformance with specifications or fails to perform at all due to underfunding. In these cases deliveries are delayed or prevented and the ultimate user deprived of the contracted for item.

In addition to the contractual impact of commercial bribes and kickbacks, there is a statutory prohibition regarding such activities involving a negotiated Federal contract. The statute, known as the Anti-Kickback Act (41 USC 51-54), makes it a crime for a subcontractor to make a payment to a prime contractor in order to get the award of a subcontract.

In a practical example of such a situation, the officers of a subcontractor agreed to pay substantial bribes to officers of a major DoD shipbuilder in order to get technical data enabling the subcontractor to get large subcontracts. Once the subcontracts were awarded, additional substantial kickbacks were paid to officers of the prime to keep the subcontracts and influence the award of subsequent ones. The kickbacks were paid by creating phony companies. The subcontractor made payments to these phony companies for nonexistent services. The checks were negotiated through a series of nominees until the funds were ultimately deposited to Swiss bank accounts held by officers of the prime. The payments were so substantial they contributed greatly to the subcontractor going bankrupt before completing the required work. The officers of the subcontractor who paid the kickbacks formed a new company and had the subcontracts transferred to it. They continued to pay kickbacks to the same officers of the prime in order to affect this transfer. In addition to the bankruptcy of the original subcontractor, these schemes resulted in delays and incomplete work. Several individuals have pleaded guilty to criminal charges and the Government has filed a civil action to recoup monetary penalties and damages resulting from the scheme.

C. Gratuities

Gratuities are generally distinguished from attempted bribery in that there is usually no request for specific improper action in exchange for what is being given. Gratuities are generally given to assist in enhancing the "relationship" between the offeror and the Government employee. This "more favorable atmosphere" in which to do business may later move the employee to "lean" in the contractor's favor if needed. Some contractors have gone so far in providing gratuities as to actually budget substantial sums (in excess of $150,000 for a project in one case) to create a favorable atmosphere for their dealings with Government employees.

Dealings with those who seek to and who do business with the Government should be conducted in an objective manner, above reproach, and avoiding even the appearance of favoritism or other impropriety. Acceptance of gratuties of any kind should be avoided in order to maintain both the form and the substance of objectivity in official dealings. It should also be remembered that the offer or acceptance of a gratuity is a felony. Furthermore, the provision of a gratuity is a violation of a standard clause in DoD contracts (FAR 52.203-3).

D. Conflicts of Interest

DoD employees are generally prohibited by both criminal laws and standards of conduct requirements from taking official actions dealing with businesses in which they or their immediate families have a direct, financial interest. DoD employees should be alert to situations in which they suspect a possible conflict of interest and report these to appropriate authorities. The following recent cases are reflective of situations to which all DoD employees should be sensitive.

1. A buyer with the Defense Electronics Supply Center (DESC), along with his wife and sister-in-law, formed a company to represent various electronics companies in their efforts to obtain contracts with DESC. On numerous occasions, the buyer, who was responsible for bid solicitation and price determination for a selected series of electronic items, recommended awards of Government contracts to these same companies. The buyer also used an affiliate of the company he had formed to sell solenoids to DESC under approximately 50

9-10-84 Published by THE BUREAU OF NATIONAL AFFAIRS INC Washington D C 20037

contracts with the Government. As a DESC employee, he personally participated in the award of these contracts to his own company. No disclosure of his interest in this company was made to DESC. The buyer charged DESC over $70,000 as a result of these contracts. Based on a complaint from a co-worker at DESC, the buyer has recently been convicted under the Federal conflict of interest statute.

2. A senior medical officer, who served as a consultant to the Surgeon General of a Military Department, recommended that DoD procure an item of medical equipment on a sole source basis from one company. At no time did the officer disclose that he was a director and major stockholder in the company. When the Surgeon General agreed to the recommendation, the officer sought to recapitalize the company in anticipation of receiving a large amount of new orders. When the officer learned that he was suspected of conflict of interest, he denied his ownership in the company, and had the company prepare false and backdated documents to show that he had no involvement with the company. In addition, the officer received payments from various drug companies for drug tests performed at a military hospital but failed to disclose to the hospital the receipt of this money, which is illegal under Federal law. The allegations in this case were made by two doctors at the hospital who became aware of the medical officer's conflicts of interest. The medical officer has been convicted of Federal violations of unlawfully supplementing his income, and charged with conflict of interest, tax fraud and obstruction of justice under the Uniform Code of Military Justice.

3. A military officer, working as the chief of a subcontracts branch in the resident office of a major DoD contractor, was assigned to assist in an inquiry into possible improper billing practices by the contractor. The officer, in anticipation of his pending retirement, solicited a job offer from the contractor. Negotiations took place between the officer and the contractor and a salary was agreed upon. The officer did not notify his superiors of his intention to retire nor did he disqualify himself from his duties relating to the inquiry of the contractor during his job negotiations. The officer took numerous actions during the inquiry which directly benefited the contractor. After submitting his notice of retirement, the officer commenced working for the company while on terminal leave from the military. In his new capacity, he headed up an internal audit group of the contractor and his main job was to identify improper billing practices including those which he had previously attempted to resolve as a military officer.

CHAPTER X: CIVIL, CONTRACTUAL AND ADMINISTRATIVE REMEDIES FOR FRAUD

A. Introduction

Traditionally, Government contracting officials have relied upon the criminal justice system to police fraud by DoD contractors. This reliance has included forebearance from certain administrative and contractual actions until the criminal case is completed. However, this reliance is often misplaced for a number of reasons. First, a 1981 GAO report determined that two-thirds of all fraud cases which were referred to the Department of Justice (DOJ) for criminal actions were declined. The majority of cases were declined because the DOJ did not have adequate resources to prosecute the cases, and not because there was insufficient evidence to conclude that a fraud was committed upon the United States.

Second, criminal cases must be proven beyond a reasonable doubt. While there may be insufficient information to warrant a criminal conviction, contracting officials do not need that level of evidence to order to take administrative and contractual action.

Third, even if criminal action is taken, many serious cases are plea bargained down to minor offenses. This tends to confuse many people into incorrectly thinking that there was no proven serious offense. In one documented case, four nonappropriated fund officials pled guilty to accepting bribes from a contractor. The contractor, however, pled guilty only to a misdemeanor - trespassing on a Federal reservation. Contracting officials believed the misdemeanor was an indication that the contractor's action was not serious. In fact, the actual evidence revealed the significant nature of this criminal conduct, despite the nature of his plea.

Finally, DoD contracting officials and not the DOJ are responsible for the integrity of the DoD contracting process. The FARs and DoD implementing regulations require DoD contracting officials to take positive action on any evidence of contractor impropriety and nonresponsibility. It is therefore necessary for managers and contracting officials to be aware of and utilize the civil, administrative, and contracting powers which are available to protect the Government, to prevent further loss to the Government and to recover Government funds lost through fraud.

B. Coordinated Approach to Remedies

Because DoD officials are responsible for the integrity of DoD contracts, these officials must be prepared to take immediate action to protect the Government. This often includes positive action while a criminal investigation is under way, and before an indictment or a conviction has been obtained. Criminal cases often take years to complete and DoD can take many contractual and administrative actions on evidence less than that necessary for an indictment or conviction. Often, timely action by a contracting official, such as a preindictment suspension or a contract default termination, will aid the Government by precluding a contractor from continuing to benefit from fraudulent conduct while an investigation is under way.

Furthermore, by taking a coordinated approach to criminal, civil, contractual and administrative actions the Government is often able to induce guilty contractors into pleading guilty more quickly. Simultaneous consideration of all the remedies available to DoD and DOJ also enables the Government and the court to fashion a single comprehensive remedy package which will punish the contractor, protect the Government, and make the Government whole from any losses suffered.

While early action by contract officials is important, such actions must be coordinated with a variety of DoD and DOJ officials. For example, a recent case involved a Service member who was suspected of accepting bribes from a number of DoD contractors. While the criminal case was being investigated by the DOJ, the following related contract and administrative actions were also considered:

a. Flagging of the Service member's record to preclude his retirement;

b. Freezing of the Service member's retirement account to provide a fund against which the Government could recoup any monies lost;

c. Termination of any contracts which the contractors had obtained through bribery; and

d. Suspension of the contractors while the criminal case was under way.

In order to ensure that such coordination takes place, the Secretary of Defense directed on May 9, 1983 that each Military Department and Defense Agency appoint a centralized point of coordination for all criminal, civil, contractual and administrative actions in contract fraud and corruption cases. As a result of this memorandum, the following officials have been identified:

Army - Contract Fraud Branch, Office of the Judge Advocate General

Navy - Navy Materiel Command, Office of the Inspector General

Air Force - Office of Review and Oversight, Air Force Inspector General

DLA - Office of General Counsel

C. Civil Actions

1. Civil False Claims Act

The Government has the right to take civil action against fraudulent contractors based upon a number of statutory grounds. These civil actions are filed by DOJ and may be filed in conjunction with, after, or instead of a criminal prosecution.

The submission of a false claim to the Government can make a contractor liable to the Government both criminally and civilly. The civil False Claims Act, 31 USC 3729-3731, establishes civil liability for false claims. The act provides for a civil penalty of $2,000 per false claim and double the damages suffered by the Government. For example, if a contractor falsely certifies small business status in order to get a small business set aside contract, every claim submitted on the contract is a civil false claim, even if the contractor performs satisfactorily. The Government may recover double the value of the contract, plus $2,000 for every invoice submitted.

2. Contract Disputes Act

Under the civil False Claims Act, the Government may only recover double damages when the Government has actually suffered damages, i.e., when a false claim is paid. If an audit or investigation determines that a claim is false and payment is not made, the Government is limited to the $2,000 penalty. However, under the Contract Disputes Act, 41 USC 604, a contractor is liable to the Government for the amount of any unsupported claim, if the claim is based on fraud or misrepresentation of fact. Under this statute the Government does not have to pay the claim in order to recover.

D. Contract Actions

Under contract law and principles, the Government has the right to insist upon certain standards of responsibility and business integrity from its contractors. Any indication that a contractor has violated these principles gives the Government the right to take a variety of actions. These actions may be taken in conjunction with, after, or instead of a criminal prosecution.

1. Termination for default

The submission of a false claim or statement on a contract is clear evidence of a contractor's nonresponsibility and failure to perform on a contract. The contracting officer has the right and obligation to terminate the contract for default. Terminations for convenience are never appropriate when fraud is present on a contract.

Furthermore, certain improper actions also give rise to a statutory right to terminate for default. Under 10 USC 2207, the Government has the right to terminate any contract for default whenever a contractor offers a gratuity to a Government employee. (DAR 7-104.16 and Appendix D; FAR 52.203-3 and DFAR Appendix D.) This statute also gives the Government the right, in addition to all other default remedies, to penalize the contractor in the amount of three to ten times the value of the gratuity.

2. Denial of Claims

In addition to terminating a contract for default, DoD contracting officials also have an obligation not to pay claims which are tainted by fraud. Under the Contract Disputes Act, 41 USC 605, DoD is not authorized to "administer, settle, compromise, pay or otherwise adjust any claim involving fraud." Therefore, whenever fraud is detected on a claim, contracting officials should not take any further action on any portion of the claim without coordination with the DoJ.

3. Findings of Nonresponsibility

Under DAR 1-900 and FAR 9.1, contracts may only be awarded to responsible contractors. Contractors are required to affirmatively demonstrate their responsibility, including a satisfactory record of integrity and business ethics. Any evidence of fraud by a contractor is clearly a

matter which should be considered by contracting officers in making responsibility determinations.

4. Suspension and Debarment

Under DAR 1-600 (FAR 9.4), contractors may be precluded from doing business with the Government for the commission of fraud or for various other actions indicating a lack of business integrity. Suspension is an interim measure designed to protect the Government while a criminal investigation or trial is under way and evidence of fraud is present. A contractor may be suspended for up to 18 months while an investigation is under way, and once an indictment or civil suit is filed, the contractor remains suspended until the completion of all legal proceedings.

Debarment is a final determination of a contractor's nonresponsibility. A contractor can be debarred, based upon a conviction of a crime, or upon sufficient evidence that a contractor has repeatedly failed to perform properly or has committed acts which indicate a lack of business integrity and honesty. Debarment can be in effect for up to three years.

In order for the suspension and debarment procedures to be effective, it is essential for contracting officers to forward reports of improper contractor activity to the suspension/debarment authority at the earliest opportunity. Reporting procedures are set forth in DAR 1-608 (DoD FAR Supplement 9.472).

5. Disallowance of legal costs

Contractors who have engaged in fraud on cost type contracts are not entitled to recover legal and administrative costs relating to their defense against Government action. (DAR 15-205.52; FAR 31.205-5). It is important for contracting officers to take prompt action to require contractors to identify such costs while an investigation is under way and to deny claims for such costs in all appropriate cases.

E. Personnel Actions

The Government has a variety of remedies to take against Government employees who have colluded with contractors in fraudulent conduct or when a Government employee has engaged in improper actions such as receipt of bribes or gratuities or has been engaged in conflict of interest. These remedies include, but are not limited to:

1. Termination. The receipt of a bribe or gratuity, or actions indicating a personal conflict of interest, can justify the immediate termination of a Federal employee.

2. Revocation of a contracting officer's warrant. Contracting officer's who engage in improper conduct can lose their right to contract on behalf of the Government.

3. Recoupment of funds lost. Whenever a contractor gives a bribe or gratuity to a Government employee, both the contractor and the employee are jointly liable to the Government for an amount equal to the value of the bribe or gratuity. Action should be taken to deduct the value of any such bribe or gratuity from the pension contributions of the employee, prior to the termination of the employee. Similar actions can be taken against military personnel and retirees.

* * *

Published by THE BUREAU OF NATIONAL AFFAIRS, INC., Washington, D.C. 20037

The "New Morality" Environment in Government Contracts

by C. Stanley Dees

Most government contractors cannot afford to believe that the increasing number of criminal investigations and prosecutions related to procurement represents only a temporary phase. Contractors must not assume that no long-term changes are warranted. The possible consequences - criminal conviction and, more important, suspension or debarment - are too severe and not al all remote. In fact, the continued focus on procurement fraud, waste, and abuse, including new legislation designed to enhance the government's ability to detect and punish procurement fraud, waste, the increasing volume of criminal investigations and prosecutions, and the growing number of suspended and debarred contractors, reflect a permanent change in the procurement process.

The reasons for the change in the government's business attitudes and practices are multifaceted: (1) the growing deficit and resulting reductions in federal spending on civilian programs makes it politically expedient for elected officials to denounce fraud, waste, and abuse related to defense spending; (2) the establishment of the various inspectors general created an immense investigating mechanism that must continue to uncover fraud, waste, and abuse and to save the government substantial costs in order to justify its continued existence; and, (3) the existence of fraudulent or other improper activities by some contractors and/or their employees. It is critical that contractors recognize that they are not faultless. In the current environment, it is unlikely that contractors could avert a government investigation by controlling the access of government investigators and auditors so as to prevent the discovery of a problem. To avoid criminal prosecution and suspension or debarment, the contractor must implement internal procedures designed to prevent and deter the commission of fraud or other improper activity by employees.

The Increasingly Adversarial Roles of the Government and Its Contractors

The Criminalization of the Contract Process

In a public address before the Federal Bar Association (FBA) on September 12, 1985, former United States Attorney for the Eastern District of Virginia Elsie Munsel acknowledged that the government is now prosecuting contractors for conduct that formerly was not considered criminal. She stated, "We are treat-

202-789-7628
C. Stanley Dees is a partner, McKenna, Conner & Cuneo, ABA Public Contract Law Section; and, vice president, NSIA. The author gratefully acknowledges the assistance of Michael Scheininger, Fredric Levy, Michael Janik, and Susan Barlocher in the preparation of this article.

This article was adapted from a presentation made to the American Bar Association, Section of Public Contract Law, on November 21, 1986, in Williamsburg, Virginia. It is reprinted with the permission of the American Bar Association, Section of Public Contract Law.

ing as criminal [conduct] that ten years ago was not considered criminal. As a prosecutor, it's important that the egregious [contract fraud] cases we retain the vision of what is criminal and what undermines the integrity of the [procurement] system. We are going more to the criminal side, and I think correctly [so]."

The results of this new aggressive attitude are revealed in the statistics reporter by the Department of Defense (DOD) Office of Inspector General in its Semiannual Reports to the Congress, the most recent report having been submitted on May 30, 1986. During the first half of fiscal year 1986 (FY 86), DOD criminal investigations resulted in 384 indictments and convictions. Although lower than the 502 indictments and convictions obtained in the last half of FY 85, the most recent data show a 40 percent increase in indictments. Debarments and suspensions in the first half of FY 86 totaled 417, which is a 20 percent increase from the second half of FY 85. These trends have been continuing during the past few years. Convictions and indictments increased by 29 percent from the second half of FY 84 to the first half of FY 85.

Despite these increases, Congress repeatedly has criticized the Department of Justice (DOJ) for its failure to adequately prosecute procurement fraud cases. For example, at an October 1, 1985, hearing before the Senate Judiciary Subcommittee on Administrative Practice and Procedure, Senator Charles Grassley (R-IA) stated that the DOJ Defense Procurement Fraud Unit has not accomplished its mission and that its record "doesn't match the rhetoric." Congressman Dennis Hertel (D-MI) told the House Judiciary Committee on February 5, 1986, that the DOJ record on prosecuting contractors was dismal. He noted that "Congress has made vast resources available for our nation's defense. Three hundred billion dollars have inundated a procurement system which has been unable to properly manage it... When the chances of being convicted are small, or penalties are only a few thousand dollars, the risk versus the financial reward weighs heavily in favor of charging $9,000 for a single allen wrench."

The effect of such statements has been to pressure the DOJ to initiate more prosecutions and to seek indictments in questionable cases that it otherwise would decline. One example is the reopening of the grand jury investigation of claims submitted by General Dynamics to the Navy in the mid-1970s. A grand jury conducted a lengthy review of these claims from 1978 to 1981 but did not return an indictment. The DOJ convened a new grand jury in direct response to congressional criticism.

Congressional criticism also has caused some prosecutors to adopt extreme or unreasonable positions designed to enhance media attention,. In March 1985 the General Electric Company was indicted on four counts of false claims and 104 counts of false statements, resulting in penalties of more than $1 million and a national media spotlight on the case and the cognizant U.S.

attorney. Yet these charges were based on a handful of individuals' time cards prepared in one department within a limited time period five years earlier.

Increased Use of Civil and Administrative Remedies

In addition to taking a more aggressive role in the area of criminal prosecutions, the government seeks to expand its use of civil and administrative remedies in conjunction with the criminal process. In June 1985, the DOD issued Directive Number 7050.5, titled "Coordination of Remedies for Fraud and Corruption Related to Procurement Activities." The directive establishes policies and procedures to ensure that all procurement-related investigations of fraud or corruption are monitored and reviewed so that appropriate contractual, administrative, and civil remedies, including contract terminations, suspension, and debarment, and referral to the DOJ can be taken as expediently as possible.

In September 1985 the President's Council on Integrity and Efficiency published "Guidelines for Civil Fraud Remedies and Parallel Proceedings," designed to, among other things, implement this DOD directive. The introduction to the guidelines espouses the "big bang" approach to procurement fraud. It states that "[r]ecent Supreme Court decisions regarding grand jury secrecy make it imperative for every Office of Inspector General to pursue fraud investigations from the outset in a manner which will allow the government to obtain the 'maximum bang for the investigative buck.'" To accomplish this objective, the guidelines stress the importance of parallel proceedings and of conducting audits and investigations in a manner deigned to develop and preserve evidence or parallel civil or administrative actions. Accordingly, to avoid the restrictions imposed on the government's use of federal grand jury material imposed by Rule 6(e) of the Federal Rules of Criminal Procedure, the guidelines stress that grand jury subpoenas should be used as an investigative tool only as a last resort.

The effect of these measures has been further stress on the relationship between the government and its contractors and emphasis on the adversarial aspects of the relationship. The most extreme example of the new relationship is the Air Force's announcement in June 1985 of its intent to place an Office of Special Investigations (OSI) agent at each Air Force Plant Representative Office in the country. OSI agents are criminal investigators, and are an extension of the DOJ's previous announcement that it would use undercover agents in investigating alleged procurement abuses.

Expanded Scope of Government Investigations

On June 1, 1984, the DOD inspector general (IG) issued the famous red pamphlet, titled "Indicators of Fraud in Department of Defense Procurement." This document, which was updated on June 1, 1985, serves as a primer to DOD military and civilian personnel, training them to detect fraud. The IG outlines eight specific areas where fraud is suspected:

- Fraud in obtaining government contracts, including fraud in preparing the solicitation and the specifications, bid rigging and collusion, disqualification of bids, awards made to the lowest of a small group of bidders, etc.;

- Defective pricing;
- Collusive bidding and price fixing;
- Cost mischarging;
- Product substitution;
- Progress payment fraud;
- Fast pay fraud; and,
- Bribery, gratuities, and conflicts of interest.

The IG's handbook reveals that government investigator have become more sophisticated in their understanding of the various practices and procedures that might result in the charging of improper costs to the government. Accordingly, the scope of review by government fraud investigators has increased significantly, and the government's theories of prosecution have become more novel. The following lists the most critical areas of a contractor's exposure.

Material Management

In July 1986 the DOD IG issued the Handbook on Fraud Indicators: Material. The purpose of this handbook is to help contract auditors recognize situations where the contractor may have mischarged material costs. While paying lip service to the fact that auditors are not supposed to be investigators, the handbook summarizes what the IG believes are common examples of material fraud in order to alert Defense Contract Audit Agency (DCAA) auditors. The handbook presents a number of scenarios, including:

- Ordering material under one job order and then transferring it to other job orders, thereby raising a question of whether the initial charge has been used to increase progress payment requests or vouchers. (The handbook notes that "material cost transfers are always suspect.")
- Several material transfers between work orders in response to the prioritized needs of a material requirements system.
- Transfers of residual or excess materials without transferring the costs and without reporting residual materials. Transfers of residual materials to scrap accounts or inventory write-off accounts. Basing cost projections on costs of completed orders without deducting costs or excess materials.
- Declaring items as obsolete or scrap and selling them to a warehousing firm from which they may be repurchased at higher prices.
- Including the costs for certain materials both as a direct charge and as a factor.
- Manipulating material standards by adding additional material costs where auditor are told that the "key to finding fraud indicators in material standards is to understand the contractor's system."

- Auditors are told to audit a contractor's subcontract management and to make a thorough review of the basis for subcontract costs. Expected problems include: use of planning quotes when a firm quote may have been received before the conclusion of negotiations; switching vendors; changing a make-buy decision; courtesy bidding; and, providing a low decrement factor to account for reduction in price due to bargaining with suppliers. (Auditors are informed that switching from buying to making an item is a fraud indicator and that contractors can easily manipulate historical data to provide a lower decrement factor.)

- Subcontractor kickbacks are described as "apparently a widespread, long-standing, and entrenched practice." Schemes include: "bumping"; courtesy bidding; disclosing the low bid and disqualifying low bidders. Auditors are told to look for a lack of subdivision of duties between purchasing and receiving, and poor internal controls over purchasing.

- Receiving and storing; lack of rotation or subdivision of duties in the purchasing department; instances of circumventing procedures for competition; and, "purchasing employees maintaining a standard of living obviously exceeding their income."

The IG's handbook suggests that the area of material management will be subjected to close scrutiny. The continued use or implementation of a material requirements plan (MRP) is not necessarily a solution to the problems identified by the IG's handbook. In fact, an MRP system can increase the likelihood of these problems if it automatically charges material costs to contracts but does not adjust those automatic allocations by cost transfer to reflect actual use, or if it automatically allocates available materials to the contract having the most urgent need for the materials without taking into account the contract for which the materials to the contract having the most urgent need for the materials without taking into account the contract for which the materials were initially purchased. Regardless of the material management system use, a contractor's best protection is to ensure that materials are used only in performing the contract for which they were purchased and that prompt an accurate cost transfer are made if materials are used on other contracts.

Labor Mischarging

Labor mischarging remains one of the most fertile areas for government investigation. This is due in part to the availability of evidence of irregularities, such as labor transfers and time card corrections, and in part to the accessibility to employees through floor checks. Identification of any irregularity will likely lead to a criminal investigation. In its 1985 indicators pamphlet, the DOD IG stated that "[t]he issue as to whether a mischarge was a 'mistake' or a crime often depends on the issue of intent. Managers, auditors, and contracting officers should not make assumptions about the good faith of a contractor. Investigators should examine the issue of intent. Prosecutors are likely to pursue cases where intent is established even though no substantial loss occurs, particularly where the contractor has actively sought to conceal costs."

The DOD IG issued a publication titled Handbook on Labor Fraud Indicators in August 1985. Like the handbook on material fraud indicators, this guide

for DCAA auditors identifies common situations where the potential for labor fraud exists and discusses audit techniques such as preinterview analyses and employee interviews. The scenarios presented include:

- Changes in time-charging patterns in independent research and development (IR&D) projects and significant increases in charging to overhead accounts, or labor reclassifications from direct charge to indirect. The handbook notes that misclassified IR&D projects may be the most common form of labor mischarging.

- Sudden, significant decreases in labor-charging patterns for bid and proposal (B&P) projects, or large pricing proposals with a minimum of labor hours charged to them, may indicate labor mischarging of B&P accounts.

- Reclassification of employees from indirect to direct may indicate contractor attempts to alleviate cash flow problems.

- Adjusting journal entries and transferring labor charges among different contracts and accounts. The handbook notes that "[l]abor transfers are always suspect."

Accordingly, management must be particularly sensitive to situations that may result in labor mischarging. Such situations include overrun, fixed-price type contracts, contracts under which delivery orders with individually binding ceilings are issued, and time and material or level-or-effort type contracts under which fixed rates are established for employees of differing skill levels.

Unallowable Costs, IR&D/B&P

The government increasingly has attempted to establish criminal intent arising out of the charging of questionable indirect costs. Such costs could include unallowable costs or costs that, according to the government, more properly should be allocated directly to contracts. The government's most aggressive action in this area is the indictment of General Dynamics, alleging improper charges to IR&D and B&P accounts. The General Dynamics case involves a "fixed-price best efforts" contract for the development of a prototype gun system. The contract specifications were general and the contract left many of the specifics to the discretion of the contractor. The actions that constitute the basis for the indictment involve parallel development efforts by General Dynamics which, the company believed, were not contractually required and could be properly charged as an indirect cost.

These issues present areas of substantial exposure for government contractors. Whether a cost is properly allowable, or whether it is direct or indirect, often is unclear and requires the exercise of a contractor's discretion and judgment. This is particularly true in the area of IR&D/B&P. The government historically has encouraged contractors to engage in parallel development. Indeed, in their annual evaluations of contractor IR&D to contract work. The court's recent decision in the General Dynamics case to refer certain issues to the Armed Services Board of Contract Appeals (ASBCA) confirms that this area involves complex government contract and regulatory issues. Nonetheless, the government's present scrutiny for criminal intent in what often are discretionary judgments now renders it necessary for

contractors to ensure that an internal mechanism exists to screen and document any decisions that later may be subject to question.

Defective Pricing

As in the case of labor mischarging, alleged defective pricing matters are now routinely screened for criminal ramifications. As stated in the IG's pamphlet. "[t]he deliberate concealment or misrepresentation of a single significant cost element could constitute a prosecutable crime. The establishment of intent should be the function of trained criminal investigators; auditors and contracting officials should make no assumptions that defective pricing results from unintentional conduct." In addition, the IG views his audit right under the Truth in Negotiations Act as a significant tool for gathering evidence for use in contract, administrative, civil, and criminal proceedings.

The government is becoming very aggressive and imaginative in the use of the Truth in Negotiations Act. In one recent instance, the Air Force charged Lockheed with overcharging up to $500 million on its C-5B aircraft contract. According to a DCAA audit report, the company failed to notify the Air Force of its plan to negotiate a reduction in wages with its union employees.

Under the circumstances, contractors must ensure that they have implemented policies and procedures designed to provide the government with current, complete, and accurate cost data before contract negotiations. Specific attention should be directed at ensuring that communications between the purchasing and contract administration/negotiation departments are designed to expediently provide the latter with current price quotes. Employees also should be instructed as to who in the government must receive cost and pricing data. Provision of cost and pricing data to most government employees, including DCAA auditors, often will not satisfy a contractor's obligation.

Product Substitution

Product substitution continues as an area of major concern to the government. Unauthorized deviations from contract requirements constitute a major portion of procurement related investigations and convictions. Providing unauthorized goods or services is potentially criminal, regardless of whether the substituted items are substandard or defective. According to the IG's 1985 pamphlet, "even if the item is as good, there is harm to the integrity in the competitive procurement system which is based on all competitors offering to furnish the item precisely described in the specifications." The IG further asserts that "[t]he potential for product substitution cases is greatest where DOD relies upon contractor integrity to ensure that the Government gets what it has paid for."

The prevention of product substitution problems requires the participation and control of many contractor functions. Purchasing departments must understand precisely what materials an/or items are required by the particular contract for which they are purchasing. Contractor quality assurance personnel must be instructed as to the importance of verifying that any deviations from specification requirements have been authorized in writing by the appropriate government personnel. Finally, random sampling should be conducted to ensure

that the purchasing and quality assurance personnel are performing appropriately.

Progress Payments

Government auditors and investigators have been instructed to be alert for contractors who bill the government for work not yet performed or material not yet purchased. Such a practice would improperly provide the contractor with interest-free use of government funds. In the case of contractors that do not qualify as small businesses, "over-progressing" would include billing the government for materials purchased, received, and invoiced, but for which the contractor has not yet actually paid. Although we are unaware of any indictments based solely on a theory of inaccurate progress payment requests, this remains an area in which an inattentive contractor may be charged with false claim or false statement violations.

Kickbacks

The issue of subcontractor kickbacks to prime contractors is the current focus of investigations by two congressional subcommittees. The Subcommittee on Oversight of Government Management of the Senate Governmental Affairs Committee held two hearings on subcontractor kickbacks and personnel policies that contribute to the practice. The Subcommittee on Oversight of the House Committee on Energy and Commerce also is conducting an investigation. Investigations by the FBI and the DOJ have led to several convictions of contractor personnel in the Central District of California. In New Orleans, Avondale Shipyards, Inc., has reimbursed the federal government $1.4 million for fraudulent charges resulting from kickback schemes by employees and vendors.

Congressional and media attention has focused on allegedly corrupt buyers, who, after being terminated by one company for unethical or illegal practices, are rehired as buyers by other companies. Contractors are being forced to reevaluate their personnel practices in this area, weighing the privacy and potential defamation rights of individuals against the government's and other prospective employers' need to know of improper conduct resulting in termination of employment. Contractors must constantly review their purchasing operations to ensure that problems are discovered internally. Situations involving a history of noncompetitive procurements from a single vendor or unusually large agent's commissions must be scrutinized closely. In addition, all purchasing department personnel must be advised of their obligation to report to management any potential problems.

Marketing-Related Activities: The GTE Case and Bribes/Gratuities

The types of activities engaged in by contractor marketing personnel are increasingly vulnerable to criminal prosecution and other action by the government. Marketing personnel often are required to gather "intelligence." The prosecution of GTE and three individuals represents a novel expansion of contractor liability in this area. The government alleged that representatives and agents of the company improperly obtained program element descriptions, program objective memoranda, and a five-year defense plan that contained proprietary and/or classified information. The corporation was charged with conspiring to embezzle and convert government property in

violation of 18 U.S.C. §641 and with defrauding the DOD "of the right to have its procurement process conducted free from improper and unauthorized conversion and utilization by prospective contractors of Department of Defense documents which contained proprietary and classified information." The individuals were charged with conspiracy and substantive violations of 18 U.S.C.§ 641.

In addition, contractor relationships with government personnel are being closely scrutinized to determine whether the contractor is improperly providing bribes or gratuities to government personnel. Improper gratuities have been construed to include meals, even if they are not lavish, and mementos of significant events.

Under the circumstances, the activities of contractor marketing personnel must be losely regulated and monitored. Employees should be instructed on how to react if they are offered access to otherwise restricted information. Similarly, all employees must be aware that no gratuities to government personnel are permitted under any circumstances.

Collusion

Historically, government contractors often have relied on the authorizations or instructions of government technical representatives, inspectors, or other personnel to justify deviations from or changes to contract requirements. Increasingly, however, in situations where the government employee's actions were beyond the scope of his/her authority, government and contractor personnel have come under investigation for possible criminal violations. One recent case involved discussions between contractor personnel and government technical representatives concerning the technical and cost details of delivery orders. The discussion allegedly occurred before the contractor's price proposal was formally submitted to the procuring contracting officer (PCO) and without his knowledge.

In another recent investigation, a contractor was awarded a $2 million contract for supplying 64 minicomputers and software to the Army. After delivery of 12 of the computers, the contractor was advised by high-level officials in the Automated Data Processing Branch of the Army Materiel Command that the Army wished to purchase mainframe computers of the existing contract. The contractor, in consultation with the contracting officer's (CO) technical representative, submitted to the PCO a modification that deleted the brand name of the minicomputer and substituted the contractor's name so that more powerful equipment could be supplied. The PCO signed the modification, the contract price escalated to $25 million, and 50 mainframe computers were delivered. Hundred of Army people knew about and were involved in modification.

It is undisputed that the contractor delivered equipment that conformed to what the Army ordered. Moreover, it is conceded that there were no bribes or gratuities to Army people. Nevertheless, the DOJ alleged a conspiracy between the contractor and personnel from the Army Materiel Command Automated Data Processing Branch, the purpose of which was to undermine the procurement process. The CO's technical representative also may be indicted. However, the PCO, claiming that he did not understand the contract modification when he signed it, is considered to be no more than a government witness.

The IG's pamphlet identified many additional circumstances related to the procurement process that give rise to a suspicion of fraudulent activity involving government and contractor personnel. Such circumstances include:

- Defining statements of work and specifications to fit the products or capabilities of a single contractor.
- Using statements of work, specifications, or sole-source justifications developed by or in consultation with a preferred contractor.
- Unnecessary sole-source justifications.
- Failure to assure that a sufficient number of potential competitors are aware of the solicitation.
- Improper communication with contractors at trade or professional meeting s or improper social contact with contractor representatives.
- Award of a contract to a contractor who is not the lowest responsible, responsive bidder.
- Material changes in the contract shortly after award.
- Awards made to the lowest of a very few bidders without readvertising considerations or without adequate publicity.

Conflicts of Interest

Congress has become increasingly concerned with the so-called revolving door between government (especially DOD) and private sector employment. The General Accounting Office (GAO) reported in March 1986 that many former DOD personnel were not reporting defense-related employment. The FY 86 DOD Authorization Act contains both substantive prohibitions for certain former DOD officials moving to the private sector and reporting requirements for other former DOD employees. More stringent restrictions affecting a larger number of personnel were enacted as part of the FY 87 DOD Authorization Act.

The DOJ filed a civil suit against Boeing on July 22, 1986, seeking recovery of severance payments, to employees who subsequently worked for the DOD, that were charged to the government. The case is currently under review by the Air Force Suspension and Debarment Board.

Suspension and Debarment

In the current federal campaign against fraud, waste, and abuse, suspensions and debarments have become among the most important and controversial weapons in the government's arsenal. Until the 1980s, the suspension and debarment sanctions seldom were used as a means for an agency to avoid doing business with a contractor lacking business integrity. During the past several years, partially in response to criticisms voiced during Senate hearings in 1981, government officials have imposed suspensions and debarments with increasing frequency. The Office of Federal Procurement Policy (OFPP) also responded to these criticisms, issuing Policy Letter 82-1 (47 Fed. Reg. 28,854, July 1, 1982). That Policy Letter gave suspension and

debarment sanctions government wide effect and facilitated their imposition. The FAR now reflects those revised procedures.

The Taft Memorandum and the Issue of Responsibility

On August 27, 1984, Deputy Secretary of Defense William H. Taft issued a memorandum containing "interim regulatory changes" to the DOD FAR Supplement. The memorandum required that the secretary of the concerned military service or the under secretary of defense approve any decision not to debar or any decision to debar for less than one year a contractor convicted of a felony. In addition, any decision to award a contract or an approved subcontract to a felony-convicted contractor also was to receive secretarial approval. Finally, the debarment period could be reduced only if the underlying conviction is overturned.

This virtually automatic one-year debarment appeared to be the result of the Defense Logistics Agency's (DLA) handling of the National Semiconductor Corporation Debarment. After the company was indicted, Taft sent notes to the DOD inspector general, the deputy under secretary of the DOD, and the director of DLA, urging that all convicted felons be debared for one year and suggesting that this new policy be implemented against National Semiconductor. The DLA subsequently proposed to debar National Semiconductor, but later rescinded the proposed debarment after National Semiconductor entered into a settlement agreement. Taft apparently did not believe these actions were sufficient and issued his memorandum.

The memorandum clearly violated the supposed rationale of the regulations-to assure that the government does business with responsible contractors. The language was modified in 1985 when it was incorporated into DOD FAR Supplement 9.4 Decisions to debar for one year or less (or not at all) now must be supported by a record of "mitigating factors [which] demonstrate clearly to the debarring official's complete satisfaction, that the contractor has eliminated such circumstances and has implemented effective remedial measures."

Under the revised regulations, government contractors will be more reluctant to enter into plea agreements, particularly where the effect of the debarment may dwarf the maximum criminal penalty for the felony. Most significantly, those regulations transform the debarment sanction from a discretionary means for protecting the government from non-responsible contractors to a possible additional punishment for convicted government contractors. Such a transformation can bring about a violation of the FAR provision regarding the intent of a debarment. Complicating the revised regulations, there apparently is an official policy requiring that any decision calling for less than a one-year debarment after conviction must be cleared with the deputy secretary of defense. The Packard Commission, whose recommendations are discussed later in this article, has urged that debarment be refocussed on the issue of responsibility.

Suspension Settlement Agreements

The past years have been marked by the temporary suspension from government contracting of several major contractors, including General Electric, Rockwell, General Dynamics, and GTE. The settlements negotiated by

these contractors indicate that in the future the government intends to use the leverage of suspension/debarment to gain concessions on issues unrelated to the problems that resulted in the suspension. The comprehensive settlements negotiated by General Dynamics and GTE involve not only the companies' policies and procedures related to present responsibility, but also resolution of outstanding business disputes with the government. The following outlines the provisions of the General Dynamics settlement:

- To provide the DOD with copies of all internal audit reports, independent audit reports, and contract compliance reports, except those that are privileged or do not relate to defense contract operations. To the extent the documents are privileged, to report to the government on any matters identified involving violations of contracts, statutes, regulations, or the corporate standards of conduct.

- To maintain a corporate ethics, security, and contract compliance program for a period of five years.

- To fund a separate escrow account to be used solely to pay the government for any civil and contractual liabilities arising out of any future criminal charges or civil cases alleging cost mischarging.

- To cooperate fully with any future investigation by the DOJ.

- To remove immediately all officers or employees in the event they are indicted.

- To take appropriate disciplinary action against any individual responsible for an action leading to a conviction of the corporation for violation of a federal criminal statute.

- To fire any officer or employee convicted of violation of a federal criminal statute in connection with his/her employment.

- To pay the Navy the costs it incurred related to the suspension of General Dynamics.

- Not to charge the government directly or indirectly for the costs of outside legal and accounting personnel incurred as a result of the contract compliance program.

- In the event of a conviction on the indictment that led to the suspension, not to charge directly or indirectly the costs related to the conduct of the criminal investigation and the defense of the criminal proceedings.

- Not to charge directly or indirectly the salaries and benefits of employees placed on leave of absence as a result of future indictments or convictions.

- To revise and implement the corporate policies and procedures related to ethics, IR&D/B&P charges, accounting policies and controls, spares pricing, and security in accordance with an established schedule.

- To negotiate and/or resolve 19 outstanding business disputes.

- To report monthly to the Navy on the status of the implementation of the policies and resolution of the business disputes.

Fraud Legislation

Heightened concern over fraud in government procurement has led to the introduction of numerous bill intended to remedy contractor fraud. The Reagan administration introduced its own package of legislative proposals in September 1985 as part of its Anti-Fraud Enforcement Initiative. Some of these proposals were implemented in the three fraud-related bills that were enacted in 1986.

DOD 1986 Authorization Act

The 1986 Department of Defense Authorization Act, Public Law 98-145, was signed into law in November 1985. The act increased to $1 million the maximum criminal penalty for submitting a false claim to the United States related to a DOD contract. The maximum civil penalty was raised from twice the damages to three times the damages. There provisions did not change the penalties for submitting a false claim unrelated to a defense contract. The act also prohibits a person convicted of a felony arising out of a DOD contract from working in a management or supervisory capacity on any defense contract for a period determined by the secretary of defense, but not less than one year from the date of conviction. A defense contractor who knowingly employs such an individual is subject to a fine of up to $500,000.

Program Fraud Civil Remedies Act

The Program Fraud Civil Remedies Act was enacted on October 21, 1986, as part of the Omnibus Budget Reconciliation Act of 1986. Public Law 99-509 creates a new administrative mechanism by which the government may pursue individuals or companies who allegedly submit "small" false claims and statements to the government. Under the act, the government agency to which the false claim or statement was submitted may initiate an administrative action against the wrongdoer in cases involving less than $150,000.

The act provides that the agency's investigating official, the inspector general where applicable, can begin an investigation of an alleged false claim or statement. Any finding is transmitted to the reviewing official who would be designated by the agency head. If the reviewing official determines that probable cause exists to conclude that a false claim or statement has been made, he or she must refer the matter to the attorney general, who then has 90 days to review the alleged violation and to approve or disapprove the agency''s initial determination. If the attorney general concurs, the matter is referred to a hearing examiner who then conducts a hearing to determine liability and impose a penalty if applicable. The findings of the hearing examiner may be appealed to the authority head. An individual found liable by the authority head may petition for judicial review in a federal district court.

Despite the limitation of the new law to cases amounting to $150,000 or less, it will be important for contractors to contest all allegations brought under the act. Although the act creates an "administrative" remedy, the substance of any proceeding will reflect on a contractor's integrity and may

affect a contractor's continued eligibility for federal contracts. Although the act provides that any determination of fact made in the administrative proceeding shall not be considered to be a "conclusive determination" of responsibility for suspension and debarment purposes, such facts may constitute the basis for suspension and initiation of debarment proceedings. Moreover, the act expressly requires agencies to share with DOJ all information the agency discovered during this proceedings regarding bribery, gratuities, conflict of interest, or other corruption. The DOJ is free to pursue a civil or criminal action against a contractor based on information generated by the agency proceeding.

Despite the significant number of actions the agencies are expected to initiate, the DOJ's screening procedure should eliminate many of these potential cases (some because the cases lack merit and some because the DJJ will wish to pursue a criminal case). The act may give contractors the opportunity to negotiate an administrative resolution of relatively minor incidents in lieu of a criminal prosecution. Thus, the principal importance of the statute may he in its ultimate use by contractors to avoid criminal prosecution in cases where the cost of prosecution is likely to be greater than the sums involved.

False Claims Amendments Act

The False Claims Amendments Act of 1986 was signed by President Reagan on October 27, 1986. Public Law 99-562 raises the maximum criminal penalty to five years' imprisonment and $250,000 fine for individuals, and $500,000 for corporations. The act mainly addresses civil fraud, however, and raises the penalties for civil false claims to $5,000 to $10,000, plus treble damages. The new statute defines a claim as any request for money or property that is paid or reimbursed by the United States. Subcontractor claims at all tiers are included in this definition.

The new law attempts to encourage voluntary disclosure by providing that double, rather than treble, damages will be assessed if (1) the offending individual or company makes a voluntary disclosure of all known facts with in 30 days from the date on which the company or individual "first obtained the information" regarding the offense, providing there was no knowledge of any continuing investigation at the time of disclosure; (2) the company or individual "fully cooperates" with the government in the investigation of the offense; and, (3) at the time of the disclosure, no criminal prosecution, civil action, or administrative action had begun.

The new statute employs a tort standard of evidence that significantly deviates from the old statute. The new standard encompasses "actual knowledge" as well as "deliberate ignorance" and "reckless disregard" of the truth or falsity of the claim. The act also specifies that the government need not prove specific intent to defraud. This combination of terms substantially liberalizes the requirement to show specific intent previously applicable in most jurisdictions. Furthermore, the act establishes that the government shall be entitled to judgment on proof by "a preponderance of the evidence."

The act also greatly enhances the government's existing investigatory powers. Previously the government only could compel testimony pursuant to a

grand jury subpoena. The new statute authorizes the attorney general to issue a civil investigative demand (CID) for information "relevant to a false claims law investigation." A CID may be issued before any legal proceeding begins and could require the recipient to (1) produce documents; (2) provide written responses to interrogatories with a sworn certificate; and, (3) provide oral testimony under oath. The act expressly provides that any documentary material, answers to interrogatories, or transcripts of oral testimony produced under the act may be provided to a DOJ attorney for official use in connection with any court, grand jury, or federal agency case or proceeding. Thus, the CID will provide the DOJ with a means to obtain discovery while avoiding the protections inherent in the grand jury process. See United States v. Sells Eng'g, Inc., 463 U.S. 418 (1983).

The act also expands the limitations period applicable to civil false claims actions. It provides that a civil false claims action may be brought within six years after the date on which the violation is committed, or within three years after the "official of the United States charged with responsibility to act" knew or should have known of facts material to thee right of actions, up to 10 years after the violation was committed. This ambiguous provision will likely result in litigation regarding what facts are sufficient to trigger the running of the statute, and which official must know of the facts in order for the limitations period to begin. Because of the extended period of exposure, it may be prudent for contractors to change their record retention practices. Documents for which the legal retention period has expired may prove invaluable in defending against a false claims action.

Finally, the act expands the qui tam provisions allowing individuals to bring False Claims Act suits on behalf of the government. The act increases the award to which a qui tam plaintiff would be entitled in the event of a successful suit and allows the individual to remain a party to the action after the government assumes the case. Most important, the act allows individuals to bring actions based on information within the knowledge of the government and information within the public domain. The courts can award attorneys' fees to the defendant, however, if the court finds the qui tam suit to be frivolous, vexations, or brought primarily for the purpose of harassment.

These changes are likely to engender a significant increase in the number of qui tam action. The burden of defending these actions will be compounded by the provisions prohibiting an employer from taking any detrimental action against an employee who initiates or assists in the conduct of a qui tam action. Qui tam actions often are initiated by disgruntled employees with a history of poor performance. Consequently an employer will have to carefully document all problems relating to an employee's performance in order to ensure that a demotion or dismissal is not viewed as retribution for "whistle blowing" activity. Otherwise, an employer may find itself litigating a "wrongful retaliation" action as well as the underlying qui tam matter.

Anti-Kickback Enforcement Act of 1986

S. 2250, which amends the Anti-Kickback Act of 1946, was signed by President Reagan on November 7, 1986. Public Law 99-634 increases the criminal and civil penalties for such wrongful conduct, requires that the industry police itself or risk breaching prime contracts, redefines kickbacks,

and imposes an additional strict civil liability on prime contractors for misconduct by their employees or subcontractors.

The amended law penalizes a knowing and willful offer or acceptance of anything of value by a contractor ore its employees for the purpose of "improperly" obtaining or rewarding favorable treatment in connection with any government prime contract, or subcontract at any tier. The amendments make three significant changes to definitions in the old law. First, the act eliminates the old statute's limited applicability to cost reimbursement contracts only. The law now applies to all contracts. Second, the term "kickback" has been modified to include the term "credit." The addition of this term may be very significant, since credits are a common denominator in c ontinuing relationships between prime contractors and subcontractors at all levels. Third, the definition of kickback has been clarified to include gratuitious payments made in both directions - upstream an downstream payments.

The act provides for government scrutiny of relations between private contractors, their employees, and agents in the same way the gratuity statute provides for examination of contractor relations with government employees. Free meals, airfare upgrades, cash bonuses to induce rush orders, and commission splitting by sales representatives all come within the purview of the bill and may be regarded as criminal by virtue of their "impropriety" - a vague term likely to be the focus of much litigation. The act also requires contractors to scrutinize the activities and bids of their subcontractors.

The statute requires the government to prove only that violation was willful (i.e., that the defendant knew what he or she was doing and was acting on his or her own volition in order to establish criminal liability). Criminal voliators are subject to a penalty of 10 years' imprisonment and a $250,000 fine ($500,000 for corporations) per instance of wrongdoing.

Civil penalties for "knowing" violations now amount to twice the amount of the kickback plus $10,000 per instance of wrongdoing. Significantly, the bill imposes an additional civil liability on contractors in the amount of the kickback for violations by its employees, subcontractors, and subcontractors' employees. The law reaches beyond accepted theories of respondent superior to impose on the contractor liability for the is conduct of not only its own employees, but of its subcontractors and their employees as well. Although the legislative history makes it clear that the prime contractor may seek reimbursement from the wrongdoer, the act makes the prime contractor the liable party. While this provision probably will be challenged in the courts, the Supreme Court has upheld this type of civil liability within the context of the Sherman Antitrust Act. The cable to civil suits by establishing a period of six years from the date of the violation, or from the date that the United States knew or first reasonably should have known of the occurrence, whichever comes later.

Other provisions of the act impose on prime contractors the obligation to: (1) institute formal anti-kickback procedures; (2) "fully cooperate" with government investigators; and, propriate authorities. The first two requirements are to be incorporated in all government contracts. Compliance with the second item will bear on a contractor's "responsibility" in suspension and debarment proceedings.

Although "reasonable" anti-kickback procedures are not defined in the legislation, the statute's sponsors intended that formal procedures be installed. Such procedures may include, but are not limited to, routinely requiring subcontractors to submit declarations that neither they nor the prime contractor's employees engaged in kickback activity; education programs; policy manuals; and, more stringent procedures for audit and reporting and applicant screening. The prime contractor's obligation to "cooperate fully" with investigating agencies presumably will require contractors and subcontractors to grant access to relevant business records. At least one recent DOD Termination of Suspension Agreement, however, specified that "full cooperation" does not require waiver of rights (e.g., attorney-client privileges) and defenses which the company, by law, is entitled to assert.

The act also requires contractors and subcontractors to promptly report "possible" violations of the statute if there is "reasonable suspicion" of a violation. This provision raises the issue of timing. To avoid unnecessary business interruption and defamation suits, a contractor may interpret the obligation as not requiring disclosure until the reasonable suspicion is based on specific evidence which focuses the inquiry on particular persons or companies.

Packard Commission

In June 1986 the President's Blue Ribbon Commission on Defense Management (Packard Commission) issued a comprehensive report on defense management to President Reagan. Part IV of that report covered the subjects of conduct and accountability, and the commission issued an expanded treatment of those subjects in a separate volume. The commission stated the context of this report clearly: 131 separate investigations pending against 45 of the 100 largest defense contractors. The major issues are similar to those listed in the IG' pamphlet: defective pricing, cost and labor mischarging, product substitution, subcontractor kickbacks, and false claims. The publicity of the past three years apparently has led the American public to believe that half of the defense budget is lost to waste and fraud, and that half of that amount is lost as a result of fraud.

Against this background, the commission urged "an especially high standard against which the adequacy of systems of contractor internal control must be measured." The commission further noted that it would not be possible "to detail specific systems of control adequate to th needs of every defense contractor." The commission, however, did find the need for improvement in three fundamental areas:

- Development of codes of conduct;
- An effective internal control system to ensure compliance, and an internal auditing capacity to monitor compliance; and,
- An effective oversight by an independent committee.

Standards of Conduct

The commission urged every contractor to review and revise or to adopt written standards of ethical business conduct and stated that these standards

of conduct should include procedures for employees to report misconduct and to protect employees who do so. Contractors should also make an effort to avoid conflicts of interest when hiring or assigning responsibilities to former DOD officials. Each contractor should develop educational or instructional systems to ensure that internal policies are understood and that ethical judgments are a regular part of the work experience.

Internal Auditing

The commission urged contractors to develop and implement systems of internal controls to ensure compliance with contractual commitments and the requirements of law and regulations. Unfortunately, the commission chose the narrow title of "internal auditing." What the commission was really seeking is a combination of two concepts: a compliance review and an internal audit. Contractors must design systems of internal control and then establish procedures for monitoring compliance. In addition, contractors should establish, expand, and train their internal audit staffs. The commission recognized that both the scope of the internal audit function and the subject matter expertise of the staffs must be expanded in to government contract problem areas.

Self-Governance Initiatives

A group of large defense contractors agreed to a document titled "Defense Initiatives on Business Ethics and Conduct," dated June 9, 1986. The initiatives contain six principles on business ethics and conduct to which the companies agreed to adhere, which "acknowledge and address corporate responsibilities under federal procurement laws and to the public." The initiative also set forth supporting programs, including a written code of business ethics and conduct; training of employees; enabling employees to report suspected violations without fear of retribution; institution of self-governance procedures that encourage working with the government to identify and correct problems; participation in an annual intercompany forum to discuss implementation of industry's principles of accountability; and, establishment of a mechanism for independent pubic accountants or other independent public accountants or other independent organizations to examine and report on each company's self-governance program.

Although these initiatives contain many positive recommendations, they could lead to the disclosure of potential problems before the company fully investigates them. Another drawback is that implementation could lead to involvement of independent public accountants in areas beyond their expertise. Also at risk is the protection of sensitive information.

The National Security Industrial Association (NSIA), in a letter to David Packard on June 6, 1986, recommended a broader approach to the issues of self-governance and government contract compliance. The NSIA letter emphasized a focus on the total system and suggested that companies launch a broad program encompassing a review of codes of ethics, procedures and policies, management oversight, access to records, disclosure, and employee training and education programs.

On July 24, 1986, Deputy Secretary of Defense William H. Taft IV sent a letter to more than 80 major defense contractors encouraging them to adopt a

policy of voluntary disclosure of problems affecting their corporate contractual relationships with the DOD. The letter urged that these corporations make a commitment to complete and timely disclosures of all "irregularities," regardless of their magnitude. Attached to the Taft letter was a "Department of Defense program for voluntry disclosures for possible fraud by defense contractors." Like the "Defense Industry Initiatives," the Taft letter emphasized individual conduct rather than compliance by the entire corporate system to federal laws and regulations. The Taft letter also raised issues of disclosure before recognition of underlying facts or before the company has conducted its own investigation. Compliance with the Taft letter also could cause problems with access to documents and protection of attorney-client privilege.

Although the Taft letter and its attachment suggest that the DOD will try to streamline the suspension and debarment process, negotiate over contractor cooperation, and focus on integrity and present responsibility, it is unclear what contractors can expect to gain from the program of voluntary disclosure. Determinations of criminal and civil proceedings will remain in the hands of the DOJ. At the request of Deputy Secretary Taft, the DOJ reviewed the July 24 letter and is determining how federal prosecutors should respond to contractors' voluntary disclosures.

Challenge to Contractors

The "new morality" environment is a product of the convergence of many factors during the past four years. One result has been an adversarial atmosphere affecting defense contractors, the DOD, and the public which ultimately will weaken national security. While defense contract fraud is a serious problem, it is not as prevalent as many believe. Furthermore, as the Packard Commission noted, neither a preponderance of government oversight nor the repeated use of criminal sanctions will make the defense acquisition system more effective.

It is up to individual contractors to devise and maintain a system of self-governance. A major part of this effort will involve devising and conducting systematic and periodic compliance reviews of policies and procedures in order to identify and correct potential problems. This will require a continual commitment by contractors; however, in the long run, these efforts will help to restore faith in defense contractors by the DOD and the American public.