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IN THE WAKE OF SPEEDY TERMINATION SETTLEMENTS

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"Persons attempting to find a motive in this narrative will be prosecuted; persons attempting to find a moral in it will be banished; persons attempting to find a plot in it will be shot."

By order of the author[s]

Per G. G., Chief of Ordnance"‡

THE Contract Settlement Act of 1944 was designed to insure speedy, fair, and final settlement of terminated war contracts.¹ Proponents of the legislation recognized that the streamlined settlement-by-negotiation procedure which it authorized would sacrifice meticulous accuracy to speed and on occasions leave loose ends temporarily unsettled. At this writing—two months after V-J Day and five months after V-E Day—there is almost universal concurrence that the standard settlement procedure prescribed under the act has attained the basic objectives of speed and fairness, and it is generally believed that finality of settlement likewise has been gained. A review of executed termination settlement agreements, however, indicates that their finality frequently is limited by reservations and exceptions to the mutual release of rights and obligations under the terminated contracts. Moreover, a termination settlement agreement is itself a contract that may embody unsettled rights and obligations which, in effect, merely replace those under the terminated contract. In this article it is proposed to analyze the nature and con-

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The opinions expressed in this article are those of the authors. They are not to be taken as representing War Department policy.

‡ Notice appearing on the fly page of Mark Twain's *Huckleberry Finn*.

¹ 58 Stat. 649, 41 U.S.C.A. § 101 (1944).

sequences of the more common of these loose ends—ends which may require considerable attention by both the contractor and the Government before their contractual relationship, in fact, is finally closed.

The observations contained in this article are based upon the experiences of one of the largest wartime procurement installations in the country, the Chicago Ordnance District. Approximately one-thirtieth of all Government war expenditures were made through this office. At the end of hostilities it was administering over 2,600 production contracts with over 1,000 prime contractors, involving more than 15,000 subcontractors. Previously, the District had negotiated the settlement of more than 2,300 terminated production contracts. In view of the size of its operations and the diversification in its procurements, there is reason to assume that the experiences of this contracting agency provide a representative cross-section of the workings of the national program for settlement of terminated war contracts.

On July 22, 1944, the Chicago Ordnance District closed the first major termination of the war program, settling a \$217,000,000 terminated tank contract with the International Harvester Company. Under this contract there were 438 first tier subcontractors and over 3,000 other subcontractors, some removed by seven or eight tiers from the prime contractor. Although it required sixteen months from the date of termination to arrive at a settlement agreement, the intricacy of the contractual arrangements and the novelty of the problems had led many persons to believe that the maze would not be unraveled for two or three years. The case provided a testing ground for many termination procedures and resulted in the establishment of several major settlement policies. When Government officials announced to the newspapers that the case had been closed, they predicted that future settlement negotiations could be completed in ninety days, and this forecast in large measure has been fulfilled. Beyond all doubt, the experiment with the International Harvester Company was a success in demonstrating the effectiveness and potentialities of winding up terminated contracts through businesslike negotiations.

On the other hand, the Harvester tank termination is a noteworthy example of the loose ends with which this article is concerned. The settlement agreement of July 22, 1944, did provide the corporation with the full amount agreed upon as fair and reasonable compensation for its efforts under the contract, and in that sense the termination was then closed. However, certain substantial rights and obligations under the terminated contract were expressly reserved in the settlement, and even at this writing—fifteen months later—some of these have not been finally concluded.

A review of the files reveals that several vexatious claims of subcontractors were excepted from the original agreement, and although these subsequently were assumed by the Government for direct settlement, a few are still not closed. Also, the rights and liabilities of the parties with respect to the \$10,480,000 of Government-owned facilities acquired under the contract were specifically left open in the settlement. The bulk of this equipment subsequently was transferred to a separate master facilities lease and a later production contract, but some even now remains subject to the terminated tank contract. To date, these facilities occupy much the same status as before the settlement agreement was signed.

At first impression these various loose ends may arouse concern, posing the question whether the settlement job is being slighted. Possibly a few cases will be found with shortcomings, but the vast majority of termination proceedings, including the Harvester case, have been conducted with thoroughness and efficiency. Certainly it is far better to have terminations settled with the speed and effectiveness of a well-knit business operation, rather than permit cumbersome and dilatory tactics to threaten our economic reconversion. Streamlined automobiles are not abandoned because they sometimes run over pedestrians; and speedy airplanes are not grounded because they occasionally collide with skyscrapers. Neither should termination settlements be wrapped in red tape because speed is accompanied by some deficiencies. But at the same time it would be ostrich-like to shut our eyes to such imperfections merely because the over-all policy is sound. It is believed that the following exploration of the causes and consequences of typical loose ends in settlements should help reduce to a minimum the shortcomings and aid in securing prompt disposition of open matters. This analysis, however, which focuses attention upon the relatively infrequent or more minor aspects of a huge enterprise, must not distort the broad perspective. By any standard, the national termination settlement program has been well conceived and successfully administered.²

STANDARD RESERVATIONS IN SETTLEMENTS

Termination settlements are normally consummated by the execution of a supplemental agreement to the terminated contract which provides that, upon the payment of an agreed amount to the contractor, "all rights and liabilities of the parties under the contract and under the [Con-

² See Fourth Report (War Contract Terminations and Settlements) by the Director of Contract Settlement to the Congress, July 1945.

tract Settlement] Act, in so far as it pertains to the contract, shall cease forthwith and be forever released," except for those items which are specifically reserved. A consideration of loose ends in termination settlements necessarily is concerned largely with the exceptions that follow this general release.

By far the largest number of such exceptions are the standard ones suggested by regulations for use in connection with the prescribed forms for settlement agreements. These standard reservations may be divided into two general classes. The first class consists of purely formal reservations of rights and obligations the parties have by virtue of statutes or executive orders, including, for example: (1) all rights of the Government to take the benefit of any adjustment under the Royalty Adjustment Act; and (2) all rights and liabilities of the parties under the Contract Settlement Act relating to removal and storage of termination inventory. In reality, these formal reservations may be superfluous inasmuch as the general release does not purport to cover these non-contractual rights and liabilities and, moreover, it is doubtful whether the parties are capable of contracting away the operation of statutes and executive orders. However, certain laws and orders commence operating as a result of a contractual relationship between the parties. The formal reservations serve to prevent contractors from erroneously assuming that termination of the contractual relationship also terminates operation of allied statutes and executive orders.

The second class of standard reservations pertains to various contractual rights and obligations which, because of their very nature, were intended by the parties to remain executory long after other phases of the contract are completed. Termination of a contract, in itself, does not alter the nature of rights and obligations such as those: (1) arising under the contract articles which relate to reproduction rights, patent infringements, inventions, and application for patents; (2) concerning the Government's contractual right to take the benefit of agreements reducing or otherwise affecting royalties paid or payable in connection with performance of the contract; (3) applicable to options, covenants not to compete, and covenants of indemnity; or (4) concerning defects in, and guarantees or warranties relating to, any completed articles or component parts furnished to the Government by the contractor pursuant to the contract. These rights and obligations are peculiar in that the facts upon which they operate might not come into existence or be uncovered until the lapse of considerable time. Nothing that can be done by the parties in settling a terminated contract will alter this condition, and so it has become stand-

ard practice to except such rights and obligations from settlement agreements.³

None of these standard reservations, however, should be considered a loose end of termination settlements. All of them are the usual strands dangling after Government contracts, and are in no sense an indication that a termination settlement is incomplete.⁴ For this reason they need not be discussed at length.

TREATMENT OF GOVERNMENT-OWNED FACILITIES IN SETTLEMENTS

Of all the matters left open in any substantial number of executed termination settlement agreements, perhaps the most mysterious, and certainly the most misunderstood, are rights and obligations concerning Government-owned facilities used by contractors in performing their production contracts. A general impression of the dollar-wise importance of these facilities may be gained from statistics compiled from records of the Chicago Ordnance District. On V-E Day, contractors of the District held approximately 30,000 pieces of Government-owned basic equipment, having an estimated cost of \$180,000,000. Most of the machines were equipped with accessories and attachments, including hand tools for operation and maintenance of the basic units. Random samplings of the property accounts indicate that there were at least four such minor items for each major piece of equipment. A large number of contractors in addition possessed Government facilities in the form of materials and fixtures incorporated into their plants to enable installation of equipment.⁵ Under

³ Arrangements may be made for eliminating some of the standard reservations. For example, a settlement agreement may provide for the release of a contractor's warranty obligations. See Joint Termination Regulation (8-10-45) para. 742.3, 742.4, 981.1 and 983.1. Contracting agencies have been instructed that before releasing such warranty liability they should determine that the Government is receiving what is deemed to be adequate consideration for the release. See Ordnance Procurement Instructions (10-1-45) para. 15,763.

⁴ At least one contractor has strongly objected to the use of standard reservations in settlement agreements. In returning a boilerplate settlement agreement "as being not in proper form," the contractor complained:

"This [agreement] covers from our standpoint complete cancellation at no cost to the Government for complete units none of which and no part of which have been delivered. Therefore the termination must be without any exceptions and those which you have interposed are irrelevant, immaterial and do not constitute cancellation.

"We desire to dispose of the matter and close our file and not be subject to further expenses by unnecessary further checking, snooping, demands for silly reports etc. etc. etc. We are trying to save the Government money but have no desire to be compelled to spend of our own to satisfy we don't know what [sic]."

⁵ In an opinion rendered on June 16, 1945, the Director of Materiel, Headquarters, Army Service Forces (War Department) ruled that the Government does not have title to a large portion of the installation materials for which the Government had directly or indirectly reimbursed its contractors. This decision, embodied in a first indorsement to the Chief of Ordnance,

some contracts the installed Government facilities even comprised plant improvements and additions designed to habilitate the contractors' premises for war production. While the more common facilities provisions in contracts were changed several times during the war, in general all obligated contractors to return the various classes of facilities and, with certain minor exceptions, to maintain them in good repair and operating condition.⁶ These obligations, and the corresponding rights of the Gov-

provided in part as follows: "It is the opinion of this office that the proper interpretation of [Procurement Regulations] is that title to installation materials not identifiably listed on [contracts] is not intended to be and is not vested in the Government by virtue of the facilities article, notwithstanding the fact that the Government may have borne the cost of such materials, directly through reimbursement of the cost or lump sum payment of installation cost or indirectly through the contract price. . . . It is important to note, however, that although as indicated above, title to the installation materials is not in the Government merely because the Government bore the cost of the installation of the facilities, the fact that facilities are installed is very material in determining their value for purposes of sale to the contractor in possession." See Ordnance Procurement Circular 137-45, June 16, 1945.

⁶ Most facilities articles in Chicago Ordnance District contracts contain one of two pairs of liability clauses. The first pair listed below was used earlier in the procurement program:

- (1) "The contractor agrees at its own expense to keep the facilities in good operating condition and repair and to make repairs and replacements to the extent that the necessity for such repairs is due to wear and tear resulting from operational activity.
 "The contractor shall not be liable for loss or destruction of or damage to the facilities unless such loss, damage, or destruction results from failure to perform the duty imposed by the preceding clause or from wilful misconduct or failure to exercise good faith on the part of the contractor's corporate officers or other representatives having supervision or direction of the operations of the whole of the contractor's business or of the whole of any plant operated by the contractor in performance of this contract.
- (2) "The contractor shall not be liable for loss or destruction of or damage to facilities title to which has vested in the Government (a) caused by any peril while the facilities are in transit off the contractor's premises, or (b) caused by any of the following perils while the facilities are on the contractor's or subcontractor's or other premises or by removal therefrom because of any of the following perils:

Fire; lightning; windstorm, cyclone, tornado, hail; explosion; riot, riot attending a strike, civil commotion; vandalism and malicious mischief; aircraft or objects falling therefrom; vehicles running on land or tracts, excluding vehicles owned or operated by the contractor or any agent or employee of the contractor; smoke; sprinkler leakage, earthquake or volcanic eruption; flood, meaning thereby rising of rivers or streams; enemy attack or any action taken by the military, naval or air forces of the United States in resisting enemy attack.

"Except to the extent of any loss or destruction of or damage to facilities for which the contractor is relieved of liability under the foregoing provisions of this paragraph, and except for reasonable wear and tear or depreciation, the facilities (other than facilities permitted to be sold) shall be returned by the contractor to the Government, or delivered by the contractor to any designee of the Government (at the time elsewhere in this article provided) in as good condition as when received by the contractor in connection with this contract. In aid of its obligation so to return the facilities, the contractor shall, at its own expense, maintain a program for the proper use, care and maintenance of the facilities, as well as a property control and accounting system consistent with good business practice, and make repairs and replacements."

ernment, form the core of "facilities questions" in termination settlements.⁷

To appreciate the scope and nature of facilities questions which may arise in connection with settling a terminated production contract, the relationship between termination settlements and loss or damage of Government-owned facilities needs to be explored. This relationship in essence rests upon the contractual alliance, if any, between the terminated contract which is being settled and the facilities which have been lost or damaged. Where facilities are held by the contractor under the provisions of a production contract which is terminated, either rights and obligations pertaining to such facilities must be concluded in the termination settlement, or the contract has to be kept open in order later to resolve facilities questions. In this sense, final disposition of rights and obligations as to facilities controlled by a terminated contract constitutes a necessary part of a full settlement of that contract. Even though resolution of facilities questions does not go to the heart of a termination settlement—which consists of compensating the contractor for cancellation of his contract—the terminated contract cannot be finally closed until rights and obligations concerning such facilities have been settled. In effect, a termination settlement which excludes relevant facilities questions is comparable to a contract which has run to completion but on which the parties have not as yet adjusted rights and liabilities in respect of facilities leased under the contract. In both situations the contractor has performed his obligations as to production and delivery of supplies, the Government has reimbursed the contractor for his work, but the facilities portion of the contract remains executory.

The facilities used by contractors in performing production contracts frequently are not held under the provisions of those contracts. Where such production contracts are terminated they may be settled in full and closed without resolving questions as to the facilities. These fundamentally different relationships may be made clear through a summary of three common arrangements under which facilities are held by contractors:

1. Facilities were acquired and are used by the contractor under the terms of a production contract. Rights and obligations as to these facilities are controlled by the production contract—and the contract may not be completely closed, even after termi-

⁷ Another group of facilities questions which have arisen in connection with terminations concern reimbursement by the Government to the contractor for the cost of acquiring or manufacturing facilities for Government account. These questions normally are resolved by an audit and seldom are controversial. Few difficulties arise in lumping reimbursement for facilities into the negotiated termination settlement, and the Chicago Ordnance District generally has followed that practice since it was authorized by regulations. In this article reimbursement problems will not be treated as "facilities questions."

nation, until such rights and obligations have been settled. At V-E Day about 9,000 of the major facilities in the Chicago Ordnance District were held by contractors on this basis.

2. Facilities were acquired by the contractor under an earlier production contract, which was either completed or terminated, and thereafter the contractor is authorized by a later production contract to continue using the facilities. In this situation, loss or damage of facilities while they are used under the later contract may be controlled by it, and, if so, full settlement of that contract upon termination must include resolution of these matters. Adjustment for loss or damage occurring under the earlier contract, as will be explained subsequently, likewise may be a necessary element of settling the later contract in full. It is estimated that on V-E Day some 7,000 major pieces of Chicago Ordnance District equipment were employed on production contracts authorizing use of facilities which had been acquired by contractors under earlier production contracts.

3. Facilities are held by the contractor under a lease which is independent of all production contracts. Here, facilities questions are to be resolved under the provisions of the lease. Where the lease is terminated and all the leased facilities were used on production contracts with a single contracting agency (which also represents the Government on the lease), it might be advisable for convenience to combine negotiations for the settlement of the terminated lease and any terminated production contracts on which the facilities were employed. Even where this is done, however, questions as to facilities under the lease are not affected by terms of the terminated production contracts, and such contracts may be settled in full without consideration of questions respecting facilities on the lease. About 14,000 major facilities of the Chicago Ordnance District were held by contractors under separate leases on V-E Day.

Inasmuch as disposition of facilities questions necessarily entails an inventory and inspection of the facilities, it is easy to understand why prior to cessation of a major portion of hostilities many contracting agencies frequently excepted facilities questions from termination settlements. After termination of a production contract under which facilities were held, the contractor in most instances would be kept in the procurement program and authorized to use the facilities on another production contract or under a facilities lease. To have settled all existing facilities questions would have meant undertaking an otherwise unnecessary inventory and inspection of the facilities at a time when manpower was vitally needed for production of supplies. Contractors as well as contracting agencies desired to avoid disrupting production and diverting skilled labor, with the result that facilities questions by mutual consent were excepted from termination settlement agreements. This lack of finality as to facilities seemed logical where the Government permitted the contractor to continue using the facilities. At best, the parties could have settled only for loss or damage which had occurred prior to the time the facilities were transferred from the jurisdiction of one document to another.

Another phase of this use of facilities on successive and several con-

tracts was the program of contracting agencies to transfer control of facilities from production contracts to master facilities leases. When facilities acquired under certain production contracts became necessary for the performance of other contracts with the same contractor, the Government found that administration of its facilities could be improved through bringing together under a single master lease most or all facilities in the possession of the contractor. Among other reasons, this consolidation was designed to reduce the number of governing instruments, standardize and equalize the terms under which facilities were held, and simplify spreading the use of facilities over a number of production contracts. The contracting agencies conducted an extensive campaign to sell contractors on the scheme, with the result in the Chicago Ordnance District that on V-E Day about 45 per cent of all major facilities were under master facilities leases. For reasons already noted, no inventory or inspection of facilities was accomplished at the time of their transfer from production contracts to facilities leases, and so the parties were not in a position to settle the facilities questions which might have arisen under the production contracts. In effect, the change-over of facilities to master leases merely postponed en masse the resolution of facilities questions—a consequence of continuing use of the facilities.

Even so, as matters have worked out in practice apparently there are no facilities questions to be resolved under the production contracts from which facilities were transferred, without inventory or inspection, to subsequent production contracts and master leases. In theory, under the terms of some older production contracts, it could be argued that loss and damage of facilities occurring prior to such transfer would be subject only to the provisions of the production contracts under which the facilities were then being employed.⁸ Actually there seldom is available data upon which to determine the precise or even approximate date of loss or damage; consequently apportioning discrepancies among consecutive contracts becomes almost impossible. Because the measure of the contractor's obligations and liabilities usually remains unchanged as facilities pass from the control of one contract to another, the contractor is unlikely to object to treating all discrepancies as having occurred under the last controlling contract. Furthermore, under the facilities clauses in more recent production contracts, the contractor's liability for loss or damage of facilities probably does not mature until the time he is required to re-

⁸ In this connection refer to the first pair of liability clauses set out in note 6 *supra*. Under these clauses it might be urged that the contractor's liability matured as of the time he failed to follow a sound maintenance program and that such liability would be enforceable only under the contract on which the facilities were held at the time of this failure.

turn the facilities, so that authorization in a subsequent contract for continued use of the facilities would preclude liability for loss or damage from accruing under the previous instrument.⁹ Although the contractual transfer of facilities without an inventory and inspection postpones settling facilities questions, this practice only nominally keeps open these questions under the earlier contracts. For this reason, the omission to resolve facilities questions in termination settlements with contractors remaining in the production program was, in most instances, a matter of little significance.

While prior to V-E Day there were relatively few contractors holding Government-owned facilities who dropped out of the war procurement program upon termination of particular production contracts, the situation thereafter was reversed. After V-J Day almost all Government-owned facilities became idle.¹⁰ It might be expected that the settlements of later-date terminations would wind up all facilities questions arising under terminated production contracts.¹¹ But the fact is that complete finality with respect to facilities has not always been achieved in termination settlements.

Contractors going out of the war program often have desired to reserve disposition of facilities questions in order to speed the execution of termination settlement agreements. Realizing that settlement of facilities questions arising under terminated contracts must rest upon inventories and inspections by Government representatives, and being informed that normally these are not undertaken until actual removal of facilities, contractors have preferred closing termination settlements by excepting all facilities questions. In other words, loose ends may result from a desire for speedy settlements and from a general appreciation of the fact that clearance of facilities from plants might not keep abreast of termination negotiations. Moreover, in many cases contractors probably feel that, since they

⁹ See the second pair of liability clauses contained in note 6 above. The most likely construction of these provisions is that the contractor's obligations for care and maintenance are tied in with his obligation to *return* the facilities at the proper time.

¹⁰ At the end of the war with Japan, about 230 contractors of the Chicago Ordnance District held Government facilities subject to the terms of production contracts.

¹¹ The authority to include resolution of facilities questions in a termination settlement is clearly set out in Joint Termination Regulation (8-10-45) para. 868(1): "If a facilities contract is included in a supply, construction or other contract which has been terminated in whole or in part, or if a separate facilities contract has been terminated in whole or in part, the liability of the war contractor for loss of and damage to plant equipment furnished to or acquired by the war contractor under the facilities contract may be settled by negotiation in and as a part of any negotiated settlement of such terminated contract. Where not settled by agreement, it may be settled in accordance with the provisions of the contract, using the procedures for a formula settlement under a fixed-price supply contract insofar as applicable."

acted in good faith in caring for Government-owned property, the reservation of facilities questions is merely a formality. Some of these very contractors are considerably surprised to learn later that, despite their good intentions, the Government treats them as liable for the value of missing facilities. Apparently these contractors forgot, or never knew, that the resolution of facilities questions not foreclosed in a negotiated termination settlement is subject to the scrutiny of a strict accounting and property audit.¹²

Two groups of Government personnel also have had reasons for excepting facilities questions from termination settlements. The first consists of termination negotiators who have been motivated by the same desire for speed as contractors in order to meet schedules set up for settlements. These work standards, and the reports predicated upon them, are a necessary and highly effective means of gauging and controlling the progress of many thousands of individuals constituting the Government termination team. In order to have a common denominator and realistic basis for charting this progress, the control system has used as its basic unit of measure the full payment of prime contractors' termination charges. Reservations in settlements which do not preclude such full payment are not in conflict with the main goal of the national program and are divorced from the basic measurement of accomplishments. Reflecting the need for performing "first things first," negotiators have had to concentrate on concluding settlements which would result in compensating prime contractors in full. Where facilities questions, being of secondary importance, interfered with the main goal, negotiators have been willing to reserve them for future disposition.

The second group which, until recently, shared the negotiators' attitude consisted of the individuals designated as responsible for maintaining Government-property accounts. The position long taken by the property officers can be explained best by an example. Suppose that through an inventory and inspection the contractor properly accounted for the condition and existence of all facilities listed on the property records, and that the termination settlement agreement contained a mutual release of all rights and obligations as to facilities held under the terminated contract. If the property officer used that release as a blanket credit to his account, what would happen if later it were discovered that a certain facility

¹² A general impression of the number of cases involving lost or damaged facilities may be gained from figures compiled from Chicago Ordnance District records. During July 1945, cases were closed with fifteen contractors. In eleven of these cases the contractors were held liable. During the following month, August, 1945, twenty-four cases were completed. Contractors were held liable in three of them.

through error initially had been omitted from the account and in fact never had been returned by the contractor?¹³ Remembering the possibility of their being liable for property not accounted for, property officers continued to request reservation of facilities questions from termination settlement agreements until assured that a mutual release of rights and obligations as to all facilities would adequately protect them where accounts were in error. Not until after V-J Day were property officers entirely satisfied as to their position under such a mutual release.¹⁴

Though contractors and Government personnel avoided consideration of facilities questions in termination settlements, at times both groups recognized that mere reservation of facilities questions was unsatisfactory for reasons other than lack of completeness and finality. The facilities provisions in production contracts generally were drafted with primary attention being given to acquisition and use of facilities, while arrangements for their maintenance and storage by the contractor after ceasing production were not spelled out in practical detail. If extensive storage or standby were likely, rather than only reserve facilities questions in a termination settlement, the parties sometimes preferred to enter into a separate maintenance or storage agreement covering the facilities. Obviously, this procedure could not conclusively settle all rights and obligations as to facilities. Moreover, since an inventory and inspection of facilities usually was not desired at the time of their transfer to a storage agreement, the parties almost always reserved facilities questions under the terminated production contract so as to leave open a means of later

¹³ A similar set of circumstances actually developed in one case in which the Chicago Ordnance District closed all facilities questions in a negotiated termination settlement. The missing machine had been moved into the plant of a subcontractor and at the time of settlement was listed on the wrong property account. Even though, as noted later in the text, the property officer now is protected in this situation, it seems questionable whether the Government gave up title to the machine by way of the release in the settlement agreement. The usual release states that all rights and liabilities under the terminated contract cease, except as otherwise specifically provided. It could be argued that such a release ends the contractor's obligation to return the once missing machine. On the other hand, it might be urged that the release does not contain words of conveyance and therefore cannot operate to pass title. That is, rights and liabilities under the contract may have ended, but the Government's title in the machine is not founded on the terminated contract; even after execution of the release, the Government would have its common law remedies to recover the machine.

¹⁴ At this writing it seems likely that in the immediate future an important reason for not concluding facilities questions in termination settlements will be that settlements will outstrip the speed with which plants are cleared of facilities. This prediction is based on the time goals established by the Chicago Ordnance District. It appears that the goals for closing termination settlements require that a large number of settlements be completed prior to clearance of the plants involved. This means, of course, that all facilities questions cannot be disposed of in such termination settlements unless the facilities remaining in the plants after settlement are placed under interim storage agreements.

settling for loss of and damage to facilities occurring prior to execution of the storage agreement. Chicago Ordnance District records indicate that in only one case of transferring facilities from a production contract to a storage agreement were rights and obligations as to facilities under the production contract released—and that arrangement was completed before the production contract was terminated.

To this point, the discussion of Government-owned facilities has been directed mainly at explaining why, in practice, facilities questions often have been reserved in termination settlements. The fact that such reservations have been common, however, apart from historical aspects, is of real significance only in view of the consequences attendant upon making these reservations. In analyzing the consequences, sight must not be lost of the consideration that virtually all termination settlements have been negotiated settlements. In short, the parties arrange for settlement through a businesslike process of give and take, which produces an overall "deal" acceptable as fair and equitable to both parties.

Reserving facilities questions from a termination settlement automatically results in excluding these questions from the give and take leading to the settlement agreement. This effect alone might be unimportant, but it almost invariably is accompanied by the situation that all liabilities in respect of facilities run exclusively from the contractor to the Government. That is, facilities questions practically always concern shortages and damages in facilities, and liability for such discrepancies in Government-owned property can only be against the contractor and in favor of the Government.¹⁵ On the other hand, a termination settlement chiefly is concerned with discharging the Government's liability to the contractor arising from cancellation of the contract. The exclusion of facilities questions from a termination settlement therefore means eliminating from the businesslike exchanges of settlement negotiations a potential liability of the contractor, and postponing consideration of it to a time when the contractor is making no claim against the Government.¹⁶

Negotiation of facilities questions at such a later date sometimes becomes extremely difficult to conduct, for the area of give and take is

¹⁵ See note 7, *supra*. In a few cases the reservation of *all* facilities questions from a termination settlement might leave certain sums owed by the Government to the contractor as reimbursement for acquisition or manufacture of facilities. However, such reimbursement generally is calculated on an audit basis, so that the area for negotiation is very limited.

¹⁶ If the contracting agency is slow in removing facilities from a contractor's plant, the contractor may be in a position to assert a claim for the expense entailed in retaining the facilities. Most facilities articles and master facilities leases provide in effect that the contractor shall retain facilities in a stand-by condition at his own expense for 90 days after they become idle and available; thereafter, the burden may be shifted to the Government.

limited to a narrow path running in but one direction. Reduced to basic elements, the situation ordinarily consists of a claim by the Government for the value of missing or damaged facilities and possible resistance to the claim on the part of the contractor. The Government representatives are under an obligation to attempt to collect payment for the value, while the contractor may well feel that his breach should be overlooked in view of his good war production record. Since the termination settlement is long past, the contractor might adopt the attitude that liability for discrepancies in facilities should be forgotten. Thus, the task of enforcing a contractor's liability is apt to be unpleasant, and with war procurement over (and no further contracts forthcoming), the resistance of contractors can be expected to increase.¹⁷ Both contractors and the Government wish to avoid future time-consuming and irritating negotiations of this nature. Were facilities questions treated as but one factor among many in the termination settlement, in all probability a fair and equitable disposition of a contractor's liability could be reached without much bickering. This is especially true inasmuch as a contractor's liability in respect of facilities normally is small in comparison to the total amount of the termination settlement.

The negotiator's report on the facilities aspect of a termination administered by the Chicago Ordnance District persuasively illustrates the advisability of a complete settlement—particularly in regard to protecting the interests of the Government. In explaining the treatment of lost and damaged facilities in the over-all deal, which involved a gross settlement of \$876,886.10 and a net settlement of \$116,022.77 for the termination of a contract to produce carbines, the negotiator stated:

Because of the protracted negotiations with the contractor and the difficulties in connection with its administration and settlement, it was decided to settle at the time of the termination all questions in connection with Government-owned as well as contractor-owned property. The agreement was made that to the extent Government-owned equipment of any kind could not be accounted for the amount of the settlement would be reduced, the amount of the reduction to be determined by an appraisal of the fair current value of the equipment missing. At the time of final settlement the property records of the District had been reduced to a zero balance with the exception of

¹⁷ During the war procurement program, there were relatively few cases in the Chicago Ordnance District in which the parties could not readily agree upon the contractor's liability for lost or damaged facilities. In most instances contractors recognized the advisability of accepting findings of the agency in order to avoid disputes. There is evidence at this writing, however, that with war procurement activity ended, some contractors are fighting hard to keep every dollar. In this connection note the prediction of two former members of the Chicago Ordnance District that, as to a contractor's obligations respecting Government facilities, "enforcement will be a difficult problem." Fain and Watt, *War Procurement—A New Pattern in Contracts*, 44 Col. L. Rev. 127, 139 (1944).

property having a fair current value of \$32,700. The settlement was reduced in this amount in consideration of the elimination of further liability on the part of the contractor for such missing property. In making this reduction it was considered that the amount thereof would adequately cover the contingency of losses arising or being made known to the government subsequent to the date the settlement agreement was signed. Further reduction was made in the sum of \$1,367.48 reflecting recovery by the government of loss through damage to Government-owned facilities. In view of this arrangement, the termination supplement does not except from the settlement the provisions of the Government-owned facilities article as all rights and liabilities of the parties under the provisions of this article are settled by the termination agreement.

The disadvantageous position of the Government resulting from not considering facilities in termination settlement negotiations also has a direct bearing upon the ultimate treatment and disposition of Government-owned facilities in the form of installation materials and plant improvements and additions. Usually these built-in facilities have little sale value after removal from the contractor's plant, and frequently the cost of removal exceeds the anticipated proceeds from a later sale. Where removal is uneconomical, and the facilities are of no substantial value to the contractor in possession and will not interfere with his commercial production, arrangements generally can be made to abandon the facilities in place.¹⁸ However, where not-readily-severable facilities are of substantial value to the contractor in possession, abandonment would confer a windfall on him. Regulations prohibit this course,¹⁹ but they also appear to preclude in many cases removing the facilities at a net loss to the Government.²⁰ The dilemma seemingly can be solved only by arranging a sale of these facilities to the contractor in possession.

¹⁸ Joint Termination Regulation (8-10-45) para. 864.4 provides: "(1) The contracting officer may discard or abandon items of plant equipment when he determines that they are worthless. . . . (2) Plant equipment which is not readily severable from the war contractor's plant and which has no substantial value to the war contractor may be considered worthless if the estimated cost of dismantling, removal and sale of such plant equipment (including the cost of repairing any damage done to the war contractor's plant to the extent that the Government may be liable therefor) exceeds the estimated net return to the Government upon sale of such plant equipment when dismantled and removed."

¹⁹ Surplus Property Board Regulation No. 6 para. 5(d) provides: "Sales of all plant equipment, not readily severable, shall be made at the fair value thereof. Fair value shall be determined by the owning agency (employing appraisers to the extent deemed necessary or desirable), and, in order to prevent windfalls, primary consideration shall be given to the value of the plant equipment to the owner of the premises for the purpose for which it is to be used."

²⁰ Joint Termination Regulation (8-10-45) para. 861.1 (4) provides: "The War Department will permit the severance of plant equipment, which is not readily severable, only if the contracting officer shall have given prior written authorization therefor. Such authorization shall be given if such plant equipment is required for redistribution for war production or in the interests of national defense. Such authorization may be given if (a) the estimated net proceeds to the Government from the plant equipment when severed will substantially exceed the estimated cost to the Government of the severance and removal, including the cost of repairing

In arriving at the sale price of not-readily-severable facilities, the Surplus Property Board has directed that primary consideration be given to the value of the facilities to the purchasing contractor.²¹ This eminently fair principle is frequently difficult of application because a hard-bargaining contractor is well aware that the alternatives to sale on his terms are abandonment or removal at a loss. Often the Government's best possibility of securing a reasonable return on its facilities is sale to the possessor while he has (or might have) claims against the Government which will be settled by negotiation. This means arranging a sale either while the contract governing the facilities is still being performed or during negotiations following its termination. After completion of the contract or settlement for its termination, the Government will be without compensating leverage in negotiating the sale of built-in facilities.

The Government's bargaining position in selling not-readily-severable facilities is of greater than usual significance. Government-owned plant improvements and additions, especially under cost-plus-a-fixed-fee contracts, frequently are relatively expensive, and their value to the contractor in possession is open to widely varying opinions. In some cases the private plant habilitated at Government expense had been idle for years prior to the war procurement program, and the contractor might insist that it will again be closed down. Under these circumstances, the contractor may refuse to recognize that the improvements and additions enhance the value of his plant. From the Government's viewpoint, however, the contractor has received a potential benefit at least to the extent that the sale value of the habilitated plant has increased. In reply the contractor may say that he does not intend to sell, and furthermore, the market for such plants is unpredictable—particularly since the Government is currently disposing of surplus plants which are only a few years old. In these and similar situations it must be admitted that the value of facilities to the contractor cannot be measured in advance by any commonly accepted standards. The parties conceivably could postpone fixing a sale price for a certain period in order to secure more enlightening facts as to value, but neither contracting agencies nor contractors have been inclined to indorse creation of such contingent liabilities. Likewise, con-

any damage to the war contractor's plant to the extent that the Government may be liable therefor . . . or (b) the war contractor in possession has requested such authorization and the plant equipment is of such a nature or is so attached to or embodied in the war contractor's plant, that the Government's failure to remove it will materially interfere with his other war production or reconversion to civilian production."

²¹ See note 19, *supra*.

tractors consistently have refused to purchase at a price subsequently to be established by a third party arbiter. Immediate negotiation of price apparently is the only mutually satisfactory method of consummating sale, and with value being largely a matter of opinion, bargaining position often is the critical element in arriving at the sale price.

In selling not-readily-severable facilities to contractors in possession, there is an exceptionally strong reason for contracting agencies to insure receipt of a fair price. Where a contractor obtains an overly liberal settlement of his termination claim, the Government can expect to recoup a substantial portion of the contractor's "excess" profit through renegotiation and taxes. These safeguards are not present where the contractor's windfall is in the form of facilities acquired at prices far below cost. Such an acquisition does not involve "income" or "profit," and the facilities need be capitalized merely at the contractor's purchase price. This consideration may lead contractors to drive hard bargains in obtaining built-in facilities from the Government. But even though enhancement in plant value over and above the price paid for Government habilitation is technically not a renegotiable or taxable profit, it may represent a real gain to the contractor. Contracting agencies have a compelling obligation to guard against conferring such hidden gains which escape public scrutiny.

In this connection contracting agencies have had to recognize that an acquisition appearing on the surface to bestow a windfall on the contractor might actually turn out to be of small value to him. Many plant improvements for war purposes are in excess of contractors' normal requirements. If a contractor should attempt to cash in through sale of excess plant capacity acquired from the Government at low prices, he would have an equally low base for the computation of any capital gain realized on the transaction. If he retains the assets, which in many cases are not designed for, or particularly adapted to, peacetime production, expensive alterations may be required before the improved plant can be efficiently put to postwar use. In addition, future depreciation would be allowable only upon the basis of the low acquisition cost.

It should also be observed that contractors who undertook plant improvements and habilitation *at their own expense* under certificates of necessity might have received even larger gains than contractors who obtain Government facilities at what appear to be bargain prices. The shortening of the amortization period from sixty months to the span of time between "acquisition date" and September 30, 1945,²² has had the effect of permitting certificate holders to acquire improvements and habilitation

²² Presidential Proclamation 2669, 10 Fed. Reg. 12475, Oct. 4, 1945.

(or even new plants) fully paid for through wartime production. Granted, certificate holders had to advance the funds for making capital improvements, while the Government advanced the money for improvements to which it reserved title. But considering that the certificate holder added the cost of built-in facilities to his other production costs, and therefore received a profit on the advance, it appears that the certificate holder usually obtained a better deal than the contractor in possession who purchased Government-owned facilities at a nominal price. This comparison is all the more pointed since the monetary risk factor proved to be almost negligible in both cases. Even so, the good fortunes of certificate holders cannot excuse contracting agencies from their duty to secure fair values on sales of built-in facilities.

Having shown the need for placing the Government in a strong bargaining position in selling not-readily-severable facilities to contractors in possession, a few case histories will illustrate the types of deals which can be arranged by combining the conveyance of built-in facilities with a negotiated termination settlement of the contract under which the facilities were acquired.

Case One involved the settlement of a terminated \$465,650,000 cost-plus-a-fixed-fee contract to produce tanks and spare parts. The contractor's plant, which previously had not been used for many years and was in a decaying condition, was rehabilitated with Government funds at an expense of approximately \$500,000. Of this amount, \$169,200 represented the installed cost of plant improvements and additions which Government experts considered as "having value to the contractor or Government." The story of how these facilities were handled in the negotiated termination settlement is clearly narrated in the following excerpts from the negotiator's report:

Summarized, the Production Service Branch found that it would cost the Government \$25,000 to dismantle and remove the rehabilitation, while the total potential salvage value of such property was only \$5,000. On the other hand, the value of the Contractor's plant would be enhanced approximately \$32,000 if the rehabilitation were left in place and intact.

The attention of the Contracting Officer was directed to the provision of Regulation No. 6 of the Surplus Property Board requiring that "sales of all plant equipment, not readily severable, shall be made at the fair value thereof. Fair value shall be determined by the owning agency . . . , and in order to prevent windfalls, primary consideration shall be given to the value of the plant equipment to the owner of the premises for the purpose for which it is to be used." After being informed that the rehabilitation property would enhance the contractor's plant by approximately \$32,000, all reasonable efforts were made to obtain a fair and proper purchase offer from the Contractor. However, the Contractor insisted that the plant used for the tank program had been idle prior to the war program and probably would not be operated after

the reconversion period. Moreover, the contractor contended that, even if the plant were operated, no-one could predict the use to which it would be devoted or the value of the plant improvements to such use. Accordingly, the contractor declined to make an offer to purchase the plant improvements and additions.

On the other hand, the Government could not economically dismantle and remove the property. Not only would it be out of pocket, but, in addition, the Government probably would have been confronted with a claim for restoration of the buildings to their original conditions. This matter likewise was referred to the Equipment Disposal Board, and the Board opposed removing the rehabilitation property.

In view of all these circumstances, the Contracting Officer and his associates decided that the Government's interests would best be served by passing title to rehabilitation property to the Contractor as part of the negotiated settlement. This concession by the Government was then used as a lever to persuade the Contractor to reduce its claim for a fixed-fee and to forego any present or future claims for restoration of the plant to its original conditions.

Case Two likewise involved a tank contract, but here negotiations for sale of plant improvements and additions were commenced prior to termination at a time when the contractor displayed some interest in acquiring these facilities. The sale was consummated after termination of the contract, and both parties considered the deal as a preliminary part of the termination settlement. Room for give and take in the negotiations was furnished by provisions in the contract obligating the Government to bear the cost of relocating the contractor's own facilities in the places from which they had been removed, and to reimburse the contractor for the expense of deferred plant repairs which could not be undertaken during performance of the contract. In arranging for the sale the parties agreed upon both the estimated cost of discharging those obligations of the Government and the apparent value of the built-in facilities to the contractor. These double-headed negotiations resulted in sale of facilities costing about \$600,000 (installed) for \$159,100, with the contractor receiving a credit of \$139,100 for releasing the above-stated obligations of the Government (which he had originally evaluated at \$345,000). All concerned were well satisfied that the Government received a fair and reasonable return for its property.

Case Three involved the negotiated settlement of a terminated \$22,600,000 contract for carbines and carbine barrels. The negotiator's report again furnishes the most realistic account of the manner in which the sale price of built-in facilities was established. In noting the following passage from the report, it is important to consider the background, consisting mainly of a termination claim by the contractor for more than \$800,000:

The amount paid to the contractor took into consideration the settlement of the government's interest in plant improvements. The Government had paid the entire cost, or a substantial part of the cost, of a bus duct system, a subterranean rifle range,

lighting fixtures, elevator alterations, dry kiln improvements, blow pipe installations, furnace pits, heat-treating room, steel floor plates and airline installation. The total amount the Government had paid in connection with these improvements was \$263,505.59. The estimated cost of the material was \$128,770.00. The [contractor] offered to pay to the Government \$27,111.00 for these installations. An appraisal by Government representatives placed the value of these installations at the end of the contract at \$47,200.00. It was estimated by Ordnance personnel that the cost of removal of these improvements would be \$25,000.00 and that recovery value after removal would be \$12,000.00. Under the circumstances it was agreed with the contractor that he would pay \$37,000.00 for title to such installations and the negotiated settlement was adjusted in this amount.²³

The contention might be raised that sale of Government property as part of the negotiated settlement of a terminated contract involves the danger that less than the stated consideration for the property would actually be received because the contractor will be rewarded with a more liberal settlement of his termination claim. This danger is recognized, but the principal safeguards of the public interest are the same whether a sale and termination settlement are consolidated or arranged separately. In the ultimate analysis, the net result in either event depends upon the integrity of the individual negotiators and the reviewing authorities to whom their recommendations are presented for final approval. Great confidence and responsibility having been placed in these men, the only conclusion is that joining the sale of not-readily-severable facilities with termination settlement negotiations affords the best and most practical opportunity of protecting the Government's interests. Speedy termination settlements might by-pass this opportunity.

²³ A fourth case supplies an object lesson that even in a negotiated settlement it sometimes is difficult for the Government to overcome the contractor's favorable position in bargaining for the purchase of built-in facilities. Consider the following passage from the negotiator's report: "In connection with the contract certain improvements and additions were made to the contractor's property where the contract was performed. The Government had title to these improvements and had paid \$104,413.48 for the cost of the work. Of this amount it was estimated that the cost of material alone was \$60,955.00. As most of this property was attached to the real estate, it was estimated that the cost of removal would be approximately \$30,000.00 and that the estimated value after removal would be approximately \$10,850.00. The Disposal and Salvage Unit of this office stated that it believed a fair price for this rehabilitation work was \$27,775.00. However, the contractor contended that this rehabilitation was of small value to him. The only installations which had any immediate value were certain electrical installations which he could use in connection with a Navy contract. For the contractor's purpose equipment which would cost approximately \$1,500.000 to install would be sufficient and, therefore, the contractor was willing to pay only \$1,800.00 for the electrical installations and \$200.00 for all of the other equipment which the Government had erected. Although it was believed this was a small return for the improvements, as it would cost the Government more to remove the facilities than they would be worth and as the possible use upon removal would be uncertain, it was believed that the sale should be made. Therefore, simultaneously with the execution of the termination settlement a sales agreement conveying title to this property to the contractor was executed. This sale was reviewed and approved by the Disposal Board of this office."

The favoring of negotiated termination settlements to guard the Government's interests in built-in facilities might seem anomalous in so far as many contracts run to completion and few were drafted in anticipation of their being terminated and settled by negotiation. Admitting the anomaly, nevertheless it appears that the circumstances of termination and settlement by negotiation fortuitously furnish a means of aiding the Government in an otherwise unfavorable situation. Early in the procurement program contracting agencies recognized that the reservation of title to not-readily-severable facilities constituted a poor device for insuring fair compensation to the Government for bearing the cost of these facilities.²⁴ However, the need for production, coupled with the strong bargaining position of potential contractors, led to making that arrangement rather common. Whether or not this expedient was wise or justifiable, the fact is that at the end of the war the Government had title to such improvements and additions in contractors' plants as walls, smokestacks, floors, heating systems, plumbing, power and lighting systems, concrete foundations, and many other objects nicely integrated into the contractors' premises. Pyramided upon the uneconomical cost of effecting removal, in some cases the Government was obligated by contract to pay the expense of repairing any damage to the contractor's plant resulting from removal.²⁵ Furthermore, at least one contractor whose plant was

²⁴ Consider, for example, the following excerpts from Ordnance Fiscal Circular No. 31, dated May 8, 1942:

"Title in the Government is, as a general rule, the best protection of the Government's interest in facilities. However, in certain instances use of none of the standardized methods of providing new facilities is practicable, usually because it is not feasible or not desirable for the Government to take title to the facilities. One reason why it may not be feasible for the Government to take title is inseparability of the new facilities from existing privately-owned facilities (examples are "rehabilitation" of a building, "scrambled" facilities, or adaptation of a machine). In these special instances detailed agreements must be entered into to protect the Government's interest in the facilities."

"As far as practicable, direct payment or direct reimbursement by the Government for the cost of new facilities should be confined to facilities which themselves form a separate unit . . . or which are readily removable or separable from the contractor's existing plant without unreasonable expense or loss of value."

²⁵ An interesting sidelight on the attempts of contractors and termination negotiators to improve their respective bargaining positions concerns the measure of damages assessable against the Government if it fails to remove its built-in facilities where required by contract to bear the expense of removal. Several contractors have asserted that, even though the built-in facilities did not diminish the value of the plant or its usefulness, the Government would be liable in damages for the estimated total cost of accomplishing removal. On the other hand, the Chicago Ordnance District generally has adopted the attitude that, in view of the principles of minimizing damages, the Government's failure would be compensable in damages measured by the smallest of the following amounts: (1) The monetary equivalent of the lost value or usefulness of the plant to the contractor; (2) The cost to the contractor of removing the Government-owned articles; (3) The cost to the contractor of restoring the value or usefulness of the plant by means other than removal of the Government-owned facilities. One

extensively improved with Government funds raised the troublesome contention that title to all built-in improvements automatically passed to him since the articles became an essential part of his realty.²⁶ In view of these circumstances, it should not be difficult to appreciate the benefits—however anomalous—conferred by termination and subsequent negotiations in which all trumps are not held in one hand.

RESERVATION OF SUBCONTRACT CLAIMS IN SETTLEMENTS

Since the very beginning of the termination program claims of subcontractors, unlike facilities questions, have been treated as within the kernel of settlements. The difference in attitude toward the two features rests on an *apparent* distinction in underlying principles. As previously noted, facilities problems generally are regarded as unrelated to fair compensation for termination claims, and therefore might seem almost foreign to a termination settlement. Subcontractors' claims, on the other hand,

corollary of this position is that only nominal damages would be assessable where failure to remove facilities merely caused annoyance or slight inconvenience to the contractor.

Another question frequently raised concerns the types of damages to contractors' plants which the Government will bear the expense of repairing where by contract the Government is required to pay the cost of removing its facilities. Answering this question necessitated an interpretation of the policy of the War Department that the cost of reconverting a contractor's plant to commercial production will not be borne by the Government except in the few instances where required by express covenants. The interpretation finally adopted is as follows: "In connection with the dismantling of plant equipment and its removal from the contractor's plant, this policy [of not paying reconversion costs] is interpreted to prohibit reimbursement of the contractor (or the assumption by the Government of the obligation to perform the work) for any items of expense relating to the restoration, repair, or alteration of the premises in order to correct a condition which was created by or resulted from the installation of the plant equipment. . . . It is recognized, however, that incidental structural damage may in some cases be caused to the premises by the operations of dismantling the plant equipment or removing it from the plant. Wherever such damage is directly and intentionally caused in the process of performing an operation which the Government is obligated by the terms of the particular contract to perform (or for the performance of which the Government is obligated to reimburse the contractor), the obligation will be interpreted to include the repair of such incidental damage at Government expense." Joint Termination Regulation (8-10-45) para. 861.2 (4) and (5).

²⁶ The Illinois courts have frequently asserted, by way of dictum, that annexed articles may not be continued as personal property where: (1) removal of the article necessarily entails material injury or serious and lasting damage to the realty, or (2) removal could not be accomplished without materially injuring the article itself or seriously impairing its usefulness. *Sword v. Low*, 122 Ill. 487, 497, 13 N.E. 826, 829 (1887); *Holland Furnace Co. v. Lithuanian, etc. Ass'n*, 286 Ill. App. 453, 464, 13 N.E. 2d 934, 938 (1936); see also *Ford v. Cobb*, 20 N.Y. 344 (1859), repeatedly cited by Illinois decisions. However, the cases mentioning such a limitation involved the rights of third persons whose interest in the real estate would be prejudiced if the realty were seriously injured through removal of the annexed articles. The rationale of the limitation disappears where rights of parties outside the agreement to continue annexations as personalty have not intervened. See dissenting opinion in *Bank of Republic v. Wells-Jackson Corp.*, 358 Ill. 356, 364, 193 N.E. 215, 221 (1934).

form a part of the prime contractor's charges and often are intricately tied in with costs incurred by the prime contractor in his own production operations. Stated in another manner, negotiators and contractors immediately understand that subcontract costs clearly are part of the cost of the supply items being procured, while they commonly fail to recognize that loss of or damage to Government-owned property, or sale of such property at unreasonably low prices, likewise affects the cost of the supply item. Consequently, unlike the attitude toward facilities questions, concerted efforts usually are made to settle and pay subcontract claims as part of the settlement of a terminated prime contract.

Despite this approach, the reservation of subcontract claims is the most common nonroutine exception in termination settlements of the Chicago Ordnance District. An examination of substantially all of the termination agreements executed by the District *prior to V-J Day* and involving settlements in excess of \$100,000 revealed that in 12 per cent of the cases certain rights relating to subcontract claims were reserved. These delays in settling with subcontractors usually stemmed from one or more of the following facts: (1) the subcontractor asserted a claim for an excessive amount; (2) the subcontractor was dilatory in presenting his claim; (3) the higher tier contractor had, or alleged he had, an unliquidated set-off against the subcontractor; and (4) the subcontractor's claim arose from matters not attributable to the termination of the prime contract. An analysis of these four difficulties encountered in the settlement of subcontracts will serve to illuminate the background and environment giving rise to those termination agreements which are incomplete as to subcontract claims.

First, consider the simple case of an immediate subcontractor who presents an excessive claim. The prime contractor after some investigation makes a determination that the claim is high, and upon reaching this conclusion, instead of promptly approving the charges for payment, sends an expeditor to the subcontractor's plant to straighten out the difficulty. After reasonable efforts, and especially if the contracting agency is urging immediate action, the prime passes the problem on to the Government representative in charge of the settlement of the prime contract. Doubting the claim, the prime contractor of course refuses to execute the usual certificate that it is fair and reasonable and not more favorable to the subcontractor than if reimbursement by the Government were not involved.²⁷ Failure to certify the claim is an automatic red flag to the Government negotiator, so he calls for an office review of the claim by an au-

²⁷ Joint Termination Regulation (8-10-45) para. 632.

ditor. If it is believed the charges are padded, a more detailed field audit may be requested. After the facts are assembled by the auditor, the negotiator normally attempts to arrange a meeting with both the prime contractor and the subcontractor in the hope that the difficulty can be ironed out. All of this takes time, and the further down the contractual chain the subcontractor is the more time it takes. If other parts of the prime contractor's claim are agreed upon and it appears that the subcontract claim cannot be closed within a reasonable time, the tendency has been to close the prime contract and reserve the delayed issue for future settlement.

A substantial portion of the excessive claims filed by subcontractors has been the product of inexperience. In spite of the efforts of the Smaller War Plants Corporation and the various training teams sponsored by the Government termination organizations, many subcontractors operating small businesses have not become familiar with termination regulations. Even though these subcontractors had access to training courses and termination literature, they generally did not employ accounting and legal specialists or negotiating talent charged with the responsibility of keeping informed as to termination developments. Contractors who have dealt directly with the Government generally have had numerous terminations, and so by actual experience have gained facility in termination operations and knowledge of termination rules. Moreover, these companies have had the advantage of securing much of their information at first hand from Government negotiators thoroughly conversant with the gamut of practical termination problems. Because of this experience prime contractors have made great strides forward in reducing the number of excessive claims and eliminating the few padded ones. The reports of the Office of Contract Settlement show that prior to June 30, 1944, terminations of fixed price contracts involving charges were settled for 80 per cent of the amount originally claimed by the contractors;²⁸ while in June of 1945, such claims were being settled for 92 per cent of the amount initially requested.²⁹ This difference undoubtedly reflects increased accuracy in the presentation of claims by prime contractors and greater familiarity with termination regulations.

Of the many excessive claims filed by subcontractors due to inexperience, most have been adjusted without delaying the complete closing of the prime contract terminations. On the other hand, a type of "excessive"

²⁸ First Report (War Contract Terminations and Settlements) by the Director of Contract Settlement to the Congress, October, 1944, Appendix C, Table 1, p. 3c.

²⁹ Fourth Report (War Contract Terminations and Settlements) by the Director of Contract Settlement to the Congress, July, 1945, Appendix B, p. 39.

claim which repeatedly has resulted in reservations in the termination settlement of prime contracts is that arising because the subcontractor insisted upon taking advantage of all legal rights under his subcontract or purchase order—which often permitted him to claim amounts in excess of those allowable under Government termination regulations. Such contentions are possible because of the lack of uniformity among contractual termination arrangements in subcontracts.

Although a uniform termination article for use in subcontracts was recommended by the Government in May of 1944,³⁰ this was too late to secure general adoption. Most contractors had worked out their own forms and were not eager to change. Many of the forms in use were an adaptation of the uniform termination article for fixed price supply contracts with the Government, and therefore similar to the recommended article for use in subcontracts. Numerous purchase orders and subcontracts outstanding at the end of the war, however, contained either no provision for termination or provisions permitting claims in excess of amounts allowable under accepted Government termination principles. The vast majority of subcontractors have not attempted to press these rights against their customers to the legal limit, but it is nevertheless true that the lack of standard legal arrangements permits an area for disagreement which might have been avoided had a uniform subcontract termination article been in use.

Typical of the problems which might have been avoided by better termination provisions in subcontracts are the disputes concerning the allowability of anticipated profit. Under the common law, profit which a contractor would have made had he completed the contract is generally a proper element of damages for breach of contract, provided the profit is demonstrable and not speculative.³¹ The Government, however, is firmly committed to a policy of paying a profit only on work done.³² From a time early in the war the termination articles in prime contracts have provided that where settlement is by formula, a reasonable profit will be allowed exclusively on costs actually incurred under the contract.³³ If a prime contractor demanded anticipated profit, he could be forced to a formula settlement, an alternative that scarcely any contractors have

³⁰ Directive Order 6 of the Office of War Mobilization, dated May 29, 1944. See also Office of Contract Settlement Regulation No. 6, contained in Joint Termination Regulation (4-20-45) p. 2526.

³¹ 5 Williston, Contracts §§ 1299, 1345, 1346 (rev. ed. 1936).

³² Joint Termination Regulation (8-10-45) para. 533.1.

³³ Joint Termination Regulation (4-20-45) para. 931.

wished to face. The contracting agencies hoped that the same principle would be incorporated into all purchase orders and subcontracts, and when a recommended form of subcontract article was issued by the Government it contained such a provision.³⁴ In addition, when claims for anticipated profit arose under subcontracts containing no corresponding limitation the Government announced that claims for unearned profit would be reimbursed only when and if they were reduced to judgment.³⁵

Thus far all claims presented to the Chicago Ordnance District by subcontractors for anticipated profit have been rejected. In at least one instance, insistence upon the full profit required the exclusion of the particular subcontract claim from the settlement with the prime contractor. One year later the subcontractor in that case consented to settle in accordance with accepted principles for computation of profit, having threatened for eleven months that he would carry the matter to court but in the end abandoning his point. By and large the cases decisively show that the claims for anticipated profit, as well as other claims which might be legally enforceable under the terms of particular termination articles but which are in excess of fair compensation and reasonable profit under the terms of the Contract Settlement Act of 1944, are used principally as negotiating weapons to assist subcontractors in positioning themselves for favorable settlements. In the last analysis the overwhelming majority of businessmen have been willing to abide by the rules which have been adopted nationally.

The second general reason subcontract claims were reserved in termination settlements prior to V-J Day was delay in presentation of the claims. Sometimes the most earnest efforts by higher-tier contractors failed to secure timely presentation of subcontractors' claims.³⁶ With primary emphasis on production, there was considerable inertia retarding the preparation and filing of claims by contractors not dealing directly with the Government. In some cases, moreover, the very remoteness of subcontractors from the prime contractor made it impossible to settle a dispute

³⁴ See note 30, *supra*.

³⁵ Joint Termination Regulation (8-10-45) para. 625.1.

³⁶ This fact is forcefully illustrated by the following excerpt from a letter written by a Chicago Ordnance District prime contractor to one of his subcontractors whose claim had been excepted from the prime's settlement with the Government. "As long as we are handling this matter, we will endeavor to administer the claim fairly, having regard to any contractual rights of the parties and any rights arising out of the Contract Settlement Act. However, our own contract with the Government was terminated nearly a year ago, and when we tell you that if we are to administer this claim we expect to have it filed within thirty days, we are not 'arbitrarily imposing a thirty day limitation.' We do not believe that it is either customary fair business or Government practice to permit matters such as this to drag along indefinitely."

between subs as quickly as the claim of the prime. It must be remembered that basically settlements follow the contractual chain: the Government deals with the prime contractor; the prime deals with his subcontractor; and the sub deals with his sub-subcontractor. Even at best it takes time for termination notices to travel down the contractual line and for claims to come back up. The time available to lower-tier contractors to settle claims must be somewhat less than that available to primes if all contracts in a hierarchy are to be closed when the prime settlement is reached. With shorter deadlines for settlements of prime contracts the problem of getting claims and settlements up the chain on time increases.

As a corollary to this matter of speed, legal complications are foreseeable in the case where there has been unreasonable delay in passing termination notices down the line. After receipt of notice of termination the prime contractor, under his contract with the Government, is obligated to terminate his orders and subcontracts; and it is contemplated that termination notices shall be passed to lower-tier contractors as rapidly as practicable. If any subcontractor continues work after the time a termination notice should have been received, neither he nor any higher-tier contractor is entitled to compensation or reimbursement from the Government for that work.³⁷ Where the Government will not be financially responsible for the extra work performed, the subcontractor nevertheless may have a perfectly good claim against his customer who failed to give notice of termination promptly.³⁸

The third circumstance which prior to V-J Day gave rise to subcontract reservations in termination settlements was delay in reaching an agreement with the subcontractor because of the existence of unliquidated set-offs in favor of the next-higher-tier contractor. Many subcontractors had limited financial resources, especially when considered in the light of the extensive expansion necessary to meet wartime production requirements. Whereas prime contractors ordinarily looked to the Government for financial support or had established financial connections through which sizable loans could be secured, the subcontractor frequently was forced to rely on his customer for additional capital. In many cases the customer advanced money to the subcontractor. In some cases the customer furnished facilities to the subcontractor. Frequently engineering assistance was provided.

³⁷ A review made by the Government shortly after V-J Day of the flow of termination notices to several major subcontractors indicated the possibility that some higher-tier contractors may have unnecessarily delayed cancellation of their purchase orders and subcontracts in certain instances. Army Service Forces Circular No. 338, September 7, 1945.

³⁸ Joint Termination Regulation (6-20-45) para. 251.3.

Many of these dependent subcontractors were not the best producers. Some were "war babies" with few experienced persons in their organizations. Others were established peacetime companies attempting to produce items entirely foreign to their usual lines. A considerable number were marginal producers to whom the war had given another lease on life. A sizable group of companies in all these classes failed in production or produced few acceptable items, while turning out great quantities which were rejected for failure to comply with Government specifications. Not infrequently the customers accepted the defective material and reworked it in order to have necessary parts in time.

As terminations came to these inferior producers, the occasion for reckoning with their customers also arrived. With managements concentrating on production rather than the financial situation, the fringe companies sometimes had failed to appreciate the extent of the various claims which the customers held and which had not been pressed perhaps because of a desire not to jeopardize further the subcontractors' production. With the full presentation of such set-offs against a subcontractor's termination claim, hard feelings occasionally resulted. In a few cases the parties reached the stage where they were hardly on speaking terms. Anticipating the set-offs, the subcontractor sometimes made his claim as high as he thought possible, and, invariably, the hard-fisted customer rebelled at paying proportionately more on termination to the inefficient and expensive producer than to top-notch suppliers. Under these circumstances negotiations frequently have been slow, and it has been necessary to except from the prime settlement the unsettled liabilities arising out of the tangled relationship.

The fourth kind of disagreement observed prior to V-J Day occurred when a subcontractor asserted a claim arising from matters not attributable to the termination or modification of the prime contract. A reasonable number of finished items in the plant of the subcontractor at the time of termination are proper elements of a termination claim and may be included at the subcontract price,³⁹ but an open account for items delivered prior to termination and for which the subcontractor has not been paid do not form a proper part of a termination claim.⁴⁰ Similarly, claims for an increased price for finished units delivered prior to termination and arising from a change in specifications do not constitute proper termination charges.⁴¹ To adopt any other position would not only result in the

³⁹ Joint Termination Regulation (8-10-45) para. 541.1.

⁴⁰ *Ibid.*, para. 541.2 and 541.3.

⁴¹ *Ibid.*

Government's paying again in a termination settlement for part of the cost of the finished items for which it previously had paid the prime contractor, but would also make the Government a guarantor of every credit risk subcontractors might have taken under a terminated war contract. More than one subcontractor, however, has insisted upon including these improper elements in his termination settlement proposal, with the result that agreement could not easily be reached.

Another difficulty of this type can be illustrated by a case which the Chicago Ordnance District recently considered. A large prime contractor cancelled a purchase order issued to one of his suppliers because in his opinion the supplier was in default. Subsequently, the prime's contract was terminated. In the settlement of this termination, rights of the defaulted subcontractor were excepted because of disagreement between the parties. Thereafter the facts were investigated by the Government in order to determine whether the claim being asserted by the subcontractor could be considered as proper for reimbursement. It was stressed in behalf of the subcontractor that the Contract Settlement Act authorizes not only the settlement of claims for a termination but also the settlement of any other claims arising under a terminated war contract.

As pointed out by the subcontractor, section 3(h) of the act defines "termination claim" as "any claim or demand by a war contractor for fair compensation for the termination of any war contract and any other claim under a terminated war contract, which regulations prescribed under this Act authorize to be asserted and settled in connection with any termination settlement." However, section 3(d) of the act states that the words "termination," "terminate," and "terminated" refer to "the termination or cancellation, in whole or in part, . . . of work under a subcontract for any reason *except the default of the subcontractor*." It is therefore clear that the phrase "termination claim" does not include a claim arising out of the termination of a purchase order because of the subcontractor's own default.

Although this may appear elementary, it is not so easily understood by the subcontractor who has received notice of a default termination a few days prior to a general termination of war contracts for the convenience of the Government. He may well feel that to deny reimbursement of his claim is discriminatory. Yet under the Contract Settlement Act and the regulations issued pursuant to it the contracting agency has no other choice. If the subcontractor persists in asserting his claim, a reservation in the prime settlement agreement becomes likely.

The above analysis of reasons for subcontract reservations is based

upon a study of terminated contracts settled prior to the surrender of Japan, and accordingly does not fully reflect the peculiar conditions existing at the time of mass terminations of war contracts. With V-J Day, the program for speedy terminations was stepped up. Primary emphasis was shifted from production to terminations. The great pressure to settle quickly thousands of terminations occurring simultaneously had obvious effects upon delaying subcontract settlements. To the existing difficulties of settling subcontracts new ones were added.

Many subcontractors were faced with the problem of filing their first termination claims. Some had never had a contract terminated; others previously had absorbed any termination costs without filing claims. For a large group the time had come to "sweep the cellar"—nothing was to be overlooked in their final claims. Many times in the past it had been possible to divert inventory to other jobs, and frequently there had been advance warning of terminations. Terminations at the end of the war came suddenly and left few opportunities to run out inventory on hand.

When these war-end terminations came, there was no further opportunity for preparation in settlement procedures and many subcontractors were still unprepared. Shortly before V-J Day the Director of Contract Settlement reported that a survey covering a sample of contractors with fewer than 400 employees revealed that 25 per cent of these smaller contractors were only partially prepared or were entirely unprepared for termination.⁴² While over 85 per cent of subcontract cancellations were being settled without claim a short time before the conclusion of hostilities in Europe,⁴³ with the end of the war in all theaters and the prospect of greatly reduced business, many subcontractors for the first time were confronted with the problem of settling numerous terminations with charges, some of a complex nature, relying on organizations relatively uninformed as to the rules of the game.

Another factor affecting subcontract settlements after V-J Day was the changed position of Government personnel. Prior to that time many Government termination negotiators assisted considerably in working out subcontractor difficulties. Where the Ordnance Department was on notice that a controversy existed, even between a remote subcontractor and an intermediate contractor with whom the Government had no privity of contract, the negotiator might intercede, ordinarily at the request of one

⁴² Fourth Report (War Contract Terminations and Settlements) by the Director of Contract Settlement to the Congress, July, 1945, p. 12.

⁴³ Third Report (War Contract Terminations and Settlements) by the Director of Contract Settlement to the Congress, April, 1945, p. 4.

of the parties, to assist in reaching a speedy adjustment of the differences. Normally such informal arbitration quickly disposed of disputes. Following V-J Day, however, Government negotiators had their desks piled high with prime contract termination problems, and had little opportunity to straighten out kinks in the contractual chain.

Since V-J Day it has also become apparent that a very substantial number of subcontract reservations arise in connection with the policy of interdistrict subcontract delegations. In the Ordnance Department, as well as in other services, termination responsibilities have been largely decentralized to district offices. These districts have reached an understanding that the district administering a terminated prime contract may delegate the negotiation of a subcontract claim to the district in which the subcontractor is located. The Chicago Ordnance District, for example, to September 1, 1945, had received 816 such delegations from other districts and had made 980 delegations. If this process of delegation functioned perfectly, it would not lead to reservations in the prime settlement agreements. The district receiving the delegation would negotiate the subcontract claim promptly and report an approved settlement amount to the prime district in time for inclusion in the settlement agreement with the prime contractor. In practice, however, delegated claims have not always been adjusted by the date the prime district is ready to close its deal—and consequently a considerable number of the delegated claims have been reserved.

The impact of all these additional factors which became evident *after V-J Day* points to an increase in the reservation of subcontract matters in termination settlements. At this writing the Chicago Ordnance District has settled very few of the more complicated terminations effectuated at V-J Day, so the full force of the added considerations has not been felt.^{43a} Nevertheless, these factors, along with the augmented pressure to close terminations, already has enlarged the relative number of incomplete termination settlements. Of the settlement agreements presented to the review board of the Chicago Ordnance District during September, 1945, 50 per cent reserved from the settlement one or more subcontract claims.⁴⁴

As an outgrowth of the demand for speed in termination settlements, there seem to be two potential sources for *future* trouble. The first, con-

^{43a} In one of the first large terminations settled after V-J Day (and after the text of this article was prepared) claims of 30 subcontractors were excepted from the prime settlement agreement.

⁴⁴ Proposed termination settlements involving over \$25,000 are submitted to the Settlement Review Board of the Chicago Ordnance District.

cerning which signs already have appeared, is that the claims of some subcontractors will have been disregarded or forgotten in the rush to close settlements of prime contracts. Having entered into mutual releases with the Government, the prime contractors in these cases might well be cold to any propositions of the excluded subcontractors. More than one prime contractor in this situation has bluntly told the subcontractor to file suit and wait for a judgment. As a result, the contracting agency may be confronted with the plea under section 7(f) of the Contract Settlement Act that "equity and good conscience require fair compensation for the termination of a war contract to be paid to a subcontractor who has been deprived of and cannot otherwise reasonably secure such fair compensation." In cases of this nature the Chicago Ordnance District has taken the position that direct payment to the subcontractor will not be considered unless the higher-tier war contractor is bankrupt or insolvent.⁴⁵ However, where other unusual circumstances exist, the service involved may consider reopening the prime settlement, under the principles discussed in the final section of this article, in order to permit reimbursement of the excluded claim.

The second and probably more frequent source of future difficulties will be the subcontract problems recognized in and reserved from termination settlements. A contracting agency cannot consider a terminated contract completely closed until such reservations have been cleared up; and in many cases the excepted subcontract matters involve complexities. An unusual illustration of the possibilities for complications existing after execution of a prime settlement agreement was exhibited in connection with the termination of a large contract for carbines settled by the Chicago Ordnance District. As the time for settlement approached two subcontractors, both controlled by the same interests, were in violent disagreement with the prime contractor. To avert delay in closing the prime settlement, Ordnance Department representatives intervened actively, in the hope that some form of mediation would expedite agreement. The Government representatives failed to bring the parties together, and in the final negotiation the prime contractor was indemnified against further liability to these two suppliers. Attorneys for the subcontractors immediately appealed to Ordnance personnel for direct payment of their

⁴⁵ In the event payment is made by the Government to a subcontractor whose customer is insolvent or bankrupt, questions arise (1) as to whether a voidable preference results from such payment, and (2) as to the position of the Government as a claimant in the estate of the bankrupt customer in those cases where the Government has taken an assignment of the termination claim of the subcontractor. See *Op. Judge Advocate General*, SPJGC 1944/12685; *Op. Att. Gen. of the United States*, dated May 19, 1945.

clients' claims, citing the objectives of the Contract Settlement Act as reasons why the Government was required to deal directly with the subcontractors. Upon failing to secure payments directly from the Government, the subcontractors then submitted their cases to the Appeal Board of the Office of Contract Settlement without the consent of the prime contractor⁴⁶ and without the specific assumption of the claims by the Government.⁴⁷ The Appeal Board concluded its opinion by stating:

In neither the Kal nor the Precision case is there proof that the contracting agency undertook to make direct settlement or accepted responsibility therefor under Section 7(d). On the contrary, the memorandum agreements of November 24, 1944 provided that, subject to approval by the Ordnance Award Board the prime contractor was authorized to pay the respective agreed amounts. It is true that the Government did endeavor, by negotiating directly with the subcontractors, to facilitate agreements between the prime contractor and the subcontractors, but this was done because of the impasse between the parties and in order to expedite complete settlement of the prime contract. In conducting these negotiations, the Government was merely discharging the duties imposed by Section 6 to provide speedy and fair compensation for war contractors, and by Section 20(f) to advise, aid and assist contractors in preparing and presenting termination claims. Such acts of assistance did not make the Government "responsible for settling appellants' claims, within the meaning of Section 13(a) so as to give a right of appeal."⁴⁸

In establishing the principle that the intervention of Government representatives in an informal manner does not give a subcontractor the right to assert a claim directly against the Government,⁴⁹ the decision of the Appeal Board provides a firm foundation to the practice of informal arbitration by termination negotiators. Even so, this practice probably

⁴⁶ See section 13(f)(1) of the Contract Settlement Act of 1944; rule 12 of Office of Contract Settlement Regulation No. 15, contained in Joint Termination Regulation (4-20-45) p. 2549.

⁴⁷ See section 7(d) of the Contract Settlement Act of 1944; rule 4 of Office of Contract Settlement Regulation No. 15, contained in Joint Termination Regulation (8-10-45) p. 2548-D.

⁴⁸ Precision Metal & Machine Co. v. War Department; Kal Machine Works, Inc. v. War Department, Office of Contract Settlement Appeal Board, Proceeding Nos. 8 and 9, August 6, 1945, CCH War Law Service, 3 CCF 1001.

⁴⁹ The difficulties of taking any other position are easily illustrated. For example, assume that a dispute exists between a first-tier subcontractor and a prime contractor. The subcontractor appeals directly to the Appeal Board of the Office of Contract Settlement, but the prime contractor does not give his consent to the appeal. When the hearing takes place the subcontractor and the Government will be represented. Unless it is found that the Government has assumed the subcontract claim and is obligated to settle it directly, the decision of the Appeal Board cannot be conclusive. The prime contractor is the party against whom the right to recover exists and the prime contractor is not a party to the appeal proceedings. In order to hold the prime contractor liable, the issues in the case would have to be submitted de novo to the courts, for there would be no basis for enforcing a judgment of the Appeal Board against a party who had not been represented before the Board. This is especially clear in the frequent case where the prime contractor and subcontractor are in disagreement over amounts due or overpaid on the completed portion of the supply contract.

will not be an adequate mechanism to cope with all the complicated subcontract matters likely to be reserved in termination settlements. In the first place, after the initial rush of V-J Day termination settlements is past and it is again possible for Government representatives to turn their attention to these vexatious subcontract cases, many of the more able and experienced negotiators will have returned to private business. Since a substantial number of the reserved cases undoubtedly will involve personality difficulties and strained feelings between the parties, the prospective lack of tactful negotiators increases the likelihood that some of these deferred cases may end up in the courts.

In the second place, whether the contracting agency *excepts* the deferred subcontract matter from the prime-settlement agreement, or *assumes* the subcontract claim for direct settlement by the Government, the position of the contracting agency often is not wholly satisfactory. Where the contracting agency merely excepts the claim from the prime termination settlement, the Government does not assume responsibility for the settlement, and the burden of taking further action rests on the prime contractor. The prime thereafter may not be greatly concerned about speedy settlement of the reserved subcontract since he will have received all the money he is entitled to by way of the prime settlement. Thus, it may be incumbent upon the contracting agency to exert pressure upon the prime contractors to clear up these exceptions.

From an operating point of view the assumption of subcontract claims for direct settlement by the Government provides even greater hazards. Assumptions not only result in undermining the basic principle that a terminated contract should be settled through the contractual chain, but may greatly handicap Government negotiators in later completing deals with the subcontractors.⁵⁰ As previously noted, many subcontracts which cannot be settled promptly involve certain complexities, and if the customer is relieved of all responsibility with respect to these contracts, his cooperation in attempting to expedite a closure and in providing facts and figures essential to an equitable settlement may be reduced. In other words, the danger inherent in the assumption by the Government of a claim for direct settlement is that one of the parties responsible for setting

⁵⁰ This discussion contemplates a situation where the Government has assumed responsibility for the determination of the amount due on account of the termination of a subcontract and the payment of such amount to the subcontractor. However, in some instances the prime contractor and subcontractor may agree upon the amount of the subcontractor's claim and the Government merely assumes responsibility for payment. This latter procedure insures prompt payment to the subcontractor where a finance company holds an assignment of the prime contractor's contract with the Government. See also Joint Termination Regulation (6-20-45) para. 662.2 and note 45, above.

up and administering the contractual arrangement—the customer—is not a party to the settlement negotiations. This frequently impedes an intelligent examination and adjustment of the difficulties.

There are, however, several situations in which it is desirable for the Government to assume and directly settle claims of subcontractors. Direct settlement is required whenever a contracting agency is satisfied that a higher-tier war contractor is, or is in serious danger of becoming, unable to meet his obligations;⁵¹ and it is permitted in cases where direct action is deemed by the Government to be necessary or desirable for expeditious and equitable settlements.⁵² Soon after V-J Day, the necessity for direct settlement of common subcontractors became increasingly apparent. For example, a supplier may be producing an identical part for as many as thirty customers located in many parts of the country. Some of the purchasers may deal directly with the Government and others may be intermediate subcontractors. It is usually economical of time and manpower to have a single termination team settle all thirty terminations rather than require thirty different purchasing agents to work out thirty separate deals with the common supplier, whose inventories and costs under the various purchase orders are necessarily commingled. In these instances the local termination office of the Government frequently will make arrangements for audit and property disposal in behalf of all of the higher-tier contractors, and in some cases there would seem to be reason for the Government to assume and pay the entire claim directly rather than to require it to be allocated and channeled through the contractual chains. Generally, the only difficult question presented to the Government, when it assumes a claim of this kind for settlement, is the extent to which the common subcontractor's costs are properly allocable to war contracts. This problem tends to become increasingly troublesome the farther removed the subcontractor is from the prime contractors to whom his products are eventually delivered.

In explaining the causes of subcontract reservations in termination settlement agreements, and in noting signs that these will increase, it has not been intended to disparage all such reservations. On the contrary, many of these reservations—as in cases revolving about a common subcontractor or insolvent prime contractor—doubtless will be of types specifically contemplated by the Contract Settlement Act. Such reservations generally are of benefit to the subcontractor involved, since they avoid multiplication of his work in presenting and settling claims or in-

⁵¹ Joint Termination Regulation (6-20-45) para. 662.3.

⁵² *Ibid.*, para. 662.4.

sure his receiving payment of termination charges. On the other hand, many reservations—such as those growing out of excessive claims, misunderstandings between customers and suppliers, and disputes involving rights of set-offs—probably will be based on situations which are aggravated by speedy termination settlements. In these cases the reservation generally is of no benefit to the subcontractor. Rather, the reservation may operate further to postpone the ultimate date of settling his claim, reduce the likelihood of settlement through mutual agreement, and handicap him in receiving prompt payment of his termination charges. Reviewing past cases, it is fair to add that in these situations the subcontractor whose claim is reserved frequently is in poor financial condition and may be placed in a disadvantageous position through delay in payment of his termination claim. Where this result prevails, one of the basic objectives of the Contract Settlement Act is defeated.

OPEN ISSUES AS TO TERMINATION INVENTORY

In contrast to the treatment of facilities questions and subcontract claims in settlement agreements, during the past year no settlement arranged by the Chicago Ordnance District has kept open under the terminated contract any rights or obligations as to inventory resulting from the termination.⁵³ Standard practice has required that all such inventory, including raw materials, purchased parts, work in process, finished components, sub-assemblies, and completed items, be accounted for prior to settlement. In effect this has meant that before the execution of the termination agreement all inventory is counted and checked to determine the contractor's claim for compensation, and then is sold or retained by the contractor or transferred to the Government, thus permitting disposal credits in favor of the Government to be calculated. Even where the contractor has agreed to store thereafter part of the inventory for the Government, all rights and liabilities pertaining to it under the terminated contract have been settled first. Under these circumstances, no need has arisen for reserving termination inventory matters from the general release in termination settlement agreements.⁵⁴

⁵³ Current regulations define contractor inventory to include Government-owned facilities (Joint Termination Regulation [8-10-45] para. 400). As used in this article, however, the term "inventory" excludes such facilities.

⁵⁴ In every settlement agreement of the Chicago Ordnance District involving any payment to the contractor, the parties have agreed in substance that: "All contract and subcontract termination inventory (including scrap), has been retained, sold, returned to suppliers, stored for the Government, delivered to the Government, or otherwise properly accounted for, and all proceeds or retention prices thereof, if any, have been taken into account in arriving at this agreement."

Nevertheless, in effecting the disposition of termination inventories certain new rights and obligations which survive the termination settlement agreement may be created—some between the parties to the terminated contract. These open issues come into existence as part of the over-all settlement procedure and in many cases are not a product of speed in making settlements.

It is to be observed, however, that there is a self-contained fundamental connection between speed in settlements and termination inventory matters. Briefly, as the pace of settlement increases there is a corresponding reduction in the time available for inventories to be disposed of by contractors directly from their plants. To some extent there is a correlation between the length of this period of time and the quantity of inventory which can be redistributed into commercial channels by contractors. As a corollary, it follows that as settlements are speeded up, the amount of inventories turned over by contractors to the Government—and then placed in warehouses—tends to increase.

These relationships are to be viewed in the perspective of the *broad outlines* of the over-all national plan for accomplishing disposition of war surpluses not required by the military establishments. Disposition is initially to be made by contractors in possession of the inventories, subject to advance or specific approval of the contracting agencies involved. At this stage retentions by contractors are encouraged and all sales are between the contractors in possession and the purchasers. The termination article in prime contracts permits the contracting agencies to direct these sales by war contractors and, by implication, allows the contracting agencies to aid in locating buyers and expediting sales.⁵⁵ All such sales are to be made in accordance with the rules prescribed by the Surplus Property Board. Title to inventories which are not redistributed in this fashion (or abandoned) is then transferred to the contracting agencies. At this second level, unserviceable property may be sold by the contracting agencies as scrap or salvage under the regulations of the Surplus Property Board, but in practice contractors generally will have been previously directed to undertake this function.⁵⁶ Serviceable property at this level, on the other hand,

⁵⁵ The uniform termination article for fixed price supply prime contracts provides: "After receipt of a Notice of Termination and except as otherwise directed by the contracting officer, the contractor shall . . . use his best efforts to sell in the manner, to the extent, at the time, and at the price or prices directed or authorized by the contracting officer, any property . . . and . . . may retain any such property at a price or prices approved by the contracting officer; . . ." Joint Termination Regulation (4-20-45) para. 931.

⁵⁶ Contractors of the Chicago Ordnance District are directed to dispose of all unserviceable property so that the agency does not take title to such inventory.

is declared as surplus to the disposal agencies designated by the Surplus Property Board. It is then either shipped directly from contractors' plants to the disposal agencies or their designees or, pending disposition by these agencies, is stored by agreement with the contractors in possession or warehoused elsewhere by the contracting agencies. Ultimately, all of this serviceable property not needed by the military establishments is turned over to disposal agencies for disposition—such disposition being the third stage of the redistribution process.⁵⁷

It is within the foregoing framework that the new and surviving issues concerning termination inventory must be considered. These issues will be examined in connection with three features commonly associated with disposition of termination inventories: (1) scrap warranties; (2) use representations; and (3) storage agreements.

The first new issue, that revolving about scrap warranties, affects a major share of all termination inventory. In general, where scrap in termination inventory is not retained for use by the contractor in possession or sold on competitive bids, the disposal must be at the best price obtainable and subject to the following warranty by the purchaser:⁵⁸

The undersigned represents and warrants to the United States that the property covered by this agreement was offered as scrap, that he is purchasing or retaining it only as scrap and that he will sell and ship or use it only as scrap, either in its existing condition or after further preparation, and only in conformity with all applicable regulations and orders of the Office of Price Administration and the War Production Board.⁵⁹

The warranty is furnished to the seller but clearly runs in favor of the Government.

The function of the scrap warranty is primarily that of a safeguard against unconscionable windfalls resulting from negotiated sales. Where property is offered for sale in a wide market and then sold to the highest bidder at scrap prices, there is small likelihood that the purchaser can resell at an unreasonably large profit. On the other hand, where material is sold on a negotiated basis without a public offering, the possibility of undervaluation is greatly increased. This undervaluation may be substantial only if the material disposed of at scrap prices in fact has use other than

⁵⁷ A full discussion of this subject is contained in Olverson, *Legal Aspects of Surplus War Property Disposal*, 31 *Vir. L. Rev.* 550 (1945).

⁵⁸ Joint Termination Regulation (8-10-45) para. 445.5, 446.3 (requiring warranty); 445.4 (not requiring warranty when property is sold on competitive bids); 445.4 (not requiring warranty when property is retained for use); 441 (miscellaneous categories of dispositions not requiring warranty).

⁵⁹ Joint Termination Regulation (8-10-45) para. 411.13.

as scrap. One means which has been employed to guard against other use, and thus realization of speculative profits, has been to mutilate the property prior to sale and so render it unusable except as scrap. Although such deliberate destruction undoubtedly will avoid resales at scandalous profits, it is costly and basically unsound economically. The scrap warranty outlaws speculative resales, but does not compel mutilation of property for which a use other than as scrap may later be found.

The significance of the use made of scrap warranties is to be appraised in the light of the sequence of situations following demands for swift plant clearances. Under existing regulations contracting agencies frequently have found that serviceable property not retained for use by contractors in possession cannot be disposed of expeditiously. To sell quantities of such property, regulations require contractors in possession to advertise the items at least seven days prior to sale, and the administrative details incident to this procedure usually consume several weeks.⁶⁰ Moreover, few contractors or contracting agencies have established organizations or market outlets for accomplishing rapid sales of serviceable property; and, desiring quick termination settlements, both of these groups have been all the more reluctant to undertake extensive sales activities. This means in practice that a large segment of serviceable inventory is slated to be turned over to the designated disposal agencies. However, with a flood of material being received, the disposal agencies have tended to discourage further receipts and often have been slow to provide shipping instructions.⁶¹ This in turn has placed the contracting agencies in the position of either making arrangements to store serviceable inventory with contractors in possession or acquiring other warehouse space so as not to delay termination settlements.

These difficulties of disposing of serviceable property, together with the evident desires of disposal agency liaison consultants to avoid overburdening the disposal agencies with property of doubtful serviceability, quickly produce a tendency for contracting agencies to find that inventory is unserviceable. This inclination appears to be given official sanction by the provision of Surplus Property Board Regulation No. 9 that "unless property affirmatively appears to be serviceable, it shall be considered to be unserviceable."⁶² Although this regulation states that unserviceable property

⁶⁰ Surplus Property Board Regulation No. 9, contained in Joint Termination Regulation (8-10-45) p. 3020 (§ 8309.12).

⁶¹ Surplus Property Board Regulation No. 1—Special Order No. 5 (May 1, 1945), CCH Surplus Disposal Law Reporter p. 4107.

⁶² Surplus Property Board Regulation No. 9, contained in Joint Termination Regulation (8-10-45) p. 3023 (§ 8309.11).

means "property that has no reasonable prospect of sale for use," it does not specify whether the test shall be an objective fair sampling of the market or a determination based upon the knowledge of administrative officials. The pressures for speed have favored the latter approach. These pressures have also largely ruled out salvaging operations necessary to separate serviceable components from the residual scrap—even though the components may have a sales value substantially in excess of the scrap value of the assembled units and the salvaging costs.

Accompanying the leaning to declare inventory unserviceable is a propensity to dispose of such property as scrap. Regulations provide that (most) sales of unserviceable property "shall be made on the basis of adequate competitive bidding."⁶³ As a practical matter, bids for this property are promptly entered by scrap and used machinery dealers, while other classes of purchasers are either difficult to reach or slow to present quotations. This limited nature of the market to some extent has been fostered by the previously noted circumstances that contracting agencies have not maintained their former contacts with other prospective purchasers, and contractors in possession have only restricted knowledge of prospective markets for such property. In this narrow market bids for unserviceable property tend to approximate current scrap prices. With differentials over and above scrap levels being so small, contracting agencies have been inclined to permit sales to fall into the scrap category so that the agencies gain protection through requesting scrap warranties. Although regulations do not require the execution of a scrap warranty where competitive bids have been secured, the Chicago Ordnance District, like many other contracting agencies, asks for the warranty in almost all sales at scrap prices.

The last step in the sequence affecting the use of scrap warranties is for contracting agencies to expedite sales of unserviceable property through eliminating time-consuming competitive bidding and substituting sales by negotiation. Regulations prescribe that in exceptional cases the requirement of competitive bidding may be waived where it "would be in the best interests of the Government" to dispose of unserviceable property by negotiated sale at the best price obtainable—provided the buyer furnishes a scrap warranty.⁶⁴ To date a wide variety of circumstances have provided justification for such negotiated sales.

Thus, the cumulative tendencies act to funnel a large portion of termination inventories under the continuing obligations of the scrap warranty.

⁶³ *Ibid.*

⁶⁴ Joint Termination Regulation (8-10-45) para. 445.5 and 446.3.

The essence of the obligation imposed by the scrap warranty is that the property purchased by the warrantor cannot be sold, shipped, or used by him other than as scrap. This obligation, running directly to the Government, is unlimited in time but does not extend to subsequent purchasers. Unlike the irrevocable consequences of mutilating material to secure protection against resales for other than scrap uses at unconscionable profits, the warrantor may divert the property to more economic uses upon securing a release of the warranty. This release may be obtained from the Government by payment to the Government of the difference between the amount for which the property was purchased as scrap and its present value for use other than scrap. Relatively few releases have been sought from the Chicago Ordnance District to date. In part this may be explained by the fact that a large share of purchases under warranty have been made by scrap dealers who under pressure usually channelled their entire stock to industrial consumers of scrap. But with the end of the war and more classes of items in termination inventories being sold as scrap under warranty, the efforts to reclaim serviceable components for use other than scrap may increase.

Breach of the scrap warranty certainly is remediable by usual contract damages, and it appears that the violator may also incur civil or criminal penalties. Contract damages, measured by the amount required to secure a release of the warranty from the Government, would be recoverable regardless of the circumstances surrounding the breach. If the breach were intentional, appropriate punitive damages might be added into the assessment. It seems, however, that criminal punishment could not be administered unless the warrantor possessed a fraudulent intent at the time of executing the warranty.⁶⁵ Likewise, the quasi-criminal penalties prescribed in section 19(c) of the Contract Settlement Act appear appropriate only if the warrantor intentionally misrepresented his purposes in accomplishing the warranty.

As a practical matter the policing and enforcement of either the civil or the criminal liability would be difficult. Contracting agencies at the present time are making no effort to police scrap warranties. While in a number of cases responsible purchasers have secured releases of the scrap warranty, other buyers, either intentionally or unintentionally, may have overlooked this precaution. It is conceivable that some agency may be delegated the task of policing these warranties in the postwar period. That this job will be onerous, and probably fruitless in proportion to the expense involved, is almost a certainty. But it is likewise almost a cer-

⁶⁵ 52 Stat. 197 (1938), 18 U.S.C.A. § 80 (Supp. 1944).

tainty that a few scandalous violations of the scrap warranty will come to light, and the warrantors guilty of making exorbitant profits on items purchased as scrap may be subjected to litigation accompanied by distasteful publicity.

The second new issue frequently created by disposition of termination inventory concerns the so-called "use representation," which currently takes the following form:

The undersigned represents to the United States that the material covered by this agreement is retained or purchased by him for his manufacturing, construction, maintenance, or repair purposes and that he intends to use or consume the material for said purposes, and that he is not retaining or purchasing the material with the intention of reselling it in its existing form at a profit.⁶⁶

This representation is a by-product of the national policy of encouraging contractors to retain their termination inventories for use. Such retentions keep inventories from becoming additional excess goods awaiting an ultimate user, and also eliminate costly and burdensome transportation and warehousing activities. From the standpoint of the national economy, retention for use probably is the most desirable form of disposition.

Being so advantageous, the Surplus Property Board has provided that a retention for use may be made at the best price obtainable without resorting to advertising or the securing of competitive bids.⁶⁷ In practice, the determination of what is the best price obtainable is usually based upon either a sampling of the market or the judgment of personnel in the contracting agencies. With respect to many classes of items, the disposal personnel have, through past experience in redistribution work, built up standards representing their appraisals of going market prices. To a large degree "best price obtainable" has come to mean a price not unreasonably lower than these standards. The use representation, in effect, is the authorization to apply such standards rather than the more rigorous test furnished by active bidding in an open market.

The drive for speedy termination settlements, limiting the time for inventory dispositions by contractors, has caused contracting agencies to

⁶⁶ Joint Termination Regulation (8-10-45) para. 411.19. Prior to mid-year 1945, the standard use representation required by the Chicago Ordnance District was as follows: "The purchaser represents and warrants to the United States that he will use or consume this property in the United States for manufacturing, construction, maintenance, or repair purposes and agrees that if he does not so use or consume it that he will not resell it at a profit." This clause creates rights and obligations similar to those under the current scrap warranty. The change over to the less stringent present form of use representation served to encourage retentions for use. Inasmuch as contractors sometimes are uncertain regarding the type and extent of the use to which inventory can be put, there was reluctance to make continuing commitments as to use.

⁶⁷ Surplus Property Board Regulation No. 9, contained in Joint Termination Regulation (8-10-45) p. 3022 (sec. 8309.8).

encourage contractors to retain inventories subject to use representations.⁶⁸ These retentions may be arranged quickly without time consuming advertising and competitive bidding. Moreover, since retentions for use are at the best price obtainable, the contracting agency is not required to determine formally whether the retained property is serviceable or un-serviceable.⁶⁹ The additional voluminous paper work attendant upon storage or shipment of the property is also avoided. On top of all these advantages is the consideration that the contracting agency runs little risk of being accused of sacrificing the inventory at an unconscionably low price. Specifically, since the retention is for *use*, there should be no subsequent resale of the property at a scandalous profit.

If there is any undesirable effect of excessive speed in connection with retentions for use, it is that contracting agencies might become careless in comparing retention offers with prices obtainable on the open market. Looseness of this nature, however, is not apt to be demonstrated except in regard to commodities for which there are established markets or recognized trade quotations. By the same token, it is on these articles that contracting agencies will have the most accurate price information. Whatever looseness results from speed probably will occur in retentions of non-standard items; for these, ascertainment of the actual best price obtainable would require a broad canvas of potential markets.

Chicago Ordnance District contractors have retained millions of dollars worth of inventory under use representations, and, like scrap warranties, no effort has been made to police these representations. Questions have been raised as to the duration of the obligations imposed upon contractors by use representations. In contrast to the scrap warranty, the use representation purports to relate only to the intention of the contractor at the moment of executing the representation. Construed strictly, the representation apparently would not preclude the giver from changing his mind and deciding to sell the retained material at a profit any time after making the representation. Some latitude seemingly was intended in so far as no procedure has been authorized for procuring the release of a use representation. Established manufacturers should encounter no difficulties in later deciding to sell at a profit the property they retained subject to a use representation; but "war babies" continued for the purpose of speculating in war surpluses may face trouble in proving their good faith under otherwise similar circumstances.

⁶⁸ It should also be observed that the very existence of the use warranty device in part stemmed from the desire for speedy termination settlements.

⁶⁹ Joint Termination Regulation (8-10-45) para. 445-3.

The third open issue related to disposition of termination inventories concerns storage agreements in which the contractor agrees to store at his plant inventory which he has conveyed to the Government as part of the settlement. In this way the contracting agencies may be relieved of having to store the property elsewhere. This arrangement eliminates unnecessary transportation, and may alleviate overcrowding in Government warehouses while the military establishment decides whether it requires the material or until the disposal agencies are ready to make space available.

To date all such storage agreements executed by the Chicago Ordnance District have been substantially the same as warehouse arrangements made with third parties not having terminated contracts. As of the time when these agreements are executed, no questions relating to compensation of the contractor for having acquired the property for war production, or disposal credits in favor of the Government, or transfer of title to the Government, remain open with respect to the property covered. The issues which do arise after settlement involve the liability of the contractor for shortages from the quantities stated in the agreements. These stated quantities are based upon the check of inventories which is part of the termination settlement—and these checks are generally upon a selective basis. The storage agreements permit variances within “commercial tolerances,” but the inaccuracies of the selective check may result in discrepancies which exceed normal commercial tolerances and thus cause the quantities stated in the storage agreement to be erroneous. Often in a case of this nature it is difficult to determine whether or not the shortage was caused by the contractor’s failure to exercise the standard of care required by the storage agreement. Upon the resolution of this question rests the determination of the contractor’s liability.⁷⁰

Despite the difficulties of administering these storage agreements (and the added clerical work entailed in their preparation), contracting agencies might have to make wholesale use of them in order to avoid delaying settlements of the mass V-J Day terminations. A storage agreement with a contractor is a stop-gap controlling the rights of the parties as to termi-

⁷⁰ Ibid. (4-20-45) para. 972.2. Records of the Chicago Ordnance District through September 15, 1945 show that in at least 28 cases shortages of inventory held by contractors under storage agreements exceeded the “tolerance constituting reasonable limits in accordance with good commercial inventory practice.”

Where the termination inventory placed in storage exceeds the quantities stated in the storage agreement, the Government nevertheless may assert title to the “overage” by virtue of the termination settlement agreement relating to the inventory.

nation inventory during the period between the date a termination settlement is concluded and the date on which the last item of termination inventory is removed from the contractor's plant. In essence, storage agreements fill the gap left when the speed of settlements outstrips the rate of plant clearances. Should any factor retard clearances—as, for example, inability of the designated disposal agencies to provide shipping instructions—contracting agencies probably will urge storage arrangements upon contractors. As settlement speed increases and Government warehouses are filled, the task of promptly clearing plants becomes more aggravated and there may be a corresponding enlargement in the use of storage agreements. If the speed of settlements precludes extensive prior selective verification of termination inventories by Government personnel, the administration of these storage agreements might involve many complexities in determining the liability of contractors for inventory discrepancies later discovered.

The repeated references which have been made in this section to the pressures for speed in settling terminations might leave the impression that contractors have taken the lead in pressing for this speed. The fact is, however, that since V-J Day the Government has been the primary sponsor of an accelerated settlement pace in order to facilitate reconversion.⁷⁴ It is obviously advantageous to both the Government and contractors that settlements be completed before the services of experienced Government personnel are lost through the demobilization process. To conform with the national policy, after victory over Japan many contracting agencies speeded up the wartime settlement tempo by means of master timetables which scheduled certain numbers of terminations to be closed during each of the last four calendar months of 1945. These schedules were not predicated upon the actual receipt of inventory submissions or plant clearance requests from contractors; consequently, to the extent that contractors are slow in furnishing inventory lists, the task of the contracting agencies becomes more difficult. First returns in the Chicago Ordnance District have indicated how the monthly target system has expedited closures. Legal details, for example, are not permitted to consume time; and in order to equal or better the “bogey” for a given month it may be necessary to complete the preparation and execution of numerous settlement contracts in the last few days of the period. The fertility of the control plan is reflected in the figures that, of 309 settlement agreements reduced to definitive instruments by the Legal Division of the District dur-

⁷⁴ See Army Service Forces Circular No. 338, September 7, 1945.

ing September, 1945, 206 were written and executed in the last seven working days of the month!^{71a}

EXTRAORDINARY RELIEF, MISTAKES, AND FRAUD

While a large portion of war contractors are concerned in termination proceedings with Government-owned facilities, subcontracts, and inventories, relatively few, fortunately, are troubled with situations involving fraud, mistakes, or need for extraordinary relief related to contract terminations. These latter matters, however, can be expected to follow in the train of a large war-procurement program. Although they have arisen to some extent during the war, by their very nature they are primarily part of the aftermath. Speedy termination settlements may affect the solution of the extraordinary relief cases and possibly increase the number of mistake and fraud situations.

During the war, contractors grew to look upon the contracting agencies as "benevolent partners" in their wartime ventures. In large measure this attitude was fostered by the prevalence of well-cushioned profit margins and, in the infrequent cases where unanticipated risks narrowed these margins or threatened losses, by the availability of extraordinary relief under the First War Powers Act and Executive Order 9001. Within a week after V-J Day this form of special relief was largely cut off, but the provisions of section 17 of the Contract Settlement Act continued to provide a means of redress in cases where contractors had done work in reliance upon apparent authority of Government agents without having secured the coverage of binding written contracts.⁷² Although contractors had become acquainted with extraordinary relief during the war, the mass contract terminations at the cessation of hostilities acted to focus attention upon the relationship between terminations and requests for special relief.

At the present time there are pending in the Chicago Ordnance District a number of cases for relief in connection with terminated contracts. The requested relief is of the type which may be granted under section 17 of the Contract Settlement Act, or which previously could have been provided under Executive Order 9001. The contracting agencies have been advised that their discretion does not authorize lumping adjustments of such pleas for special relief into negotiated termination settlements. As a practical

^{71a} The figures for November, 1945, which became available after the text of this article was prepared, are even more impressive. Of 341 settlement agreements executed, 104 were signed the last day of the month!

⁷² For a discussion of relief under Executive Order 9001 and section 17 of the Contract Settlement Act see Kramer, *Extraordinary Relief for War Contractors*, 93 *Univ. of Pa. L. Rev.* 357 (1945).

matter some contractors may be willing to forego their requests for extraordinary relief, especially if the sum involved is small, in order to expedite the closure of the termination settlements. There appears to be no objection to this procedure so long as withdrawal of the request is not reflected by an increase in the amount paid to the contractor in the settlement. A larger group of contractors, on the other hand, have indicated an unwillingness to drop their requests for special relief without securing something in return. These contractors in all probability will insist upon either postponing settlement of the terminations or expressly reserving from settlements the possibility of obtaining relief through future private or public legislation, subsequent administrative measures, or court action.

An interesting illustration of the existing special relief cases is furnished by a situation resulting from the sudden across-the-board V-J Day terminations. While in the usual case the basis of the request for extraordinary relief does not arise out of a termination, the slash in the procurement program on V-J Day caught some contractors short because of their wartime practice of proceeding without adequate written authority. For example, two of the largest contractors doing business with the Chicago Ordnance District had been producing under (informal) letter orders stating the total quantity of items to be manufactured but placing a ceiling on the amount of money the contractors were authorized to expend or obligate prior to the execution of formal contracts. In each case the contractor had incurred costs exceeding the specified limit, and with the V-J Day cut-off authority was lacking to increase the ceiling or execute a formal contract. Immediately, pleas for special relief under section 17 of the Contract Settlement Act were submitted. To a large extent these pleas rest upon the tacit wartime understanding that contractors having letter orders will proceed to produce the quantities required and that paper work adjusting fund allocations will catch up. V-J Day terminations brought a sudden realization to these contractors of the technical limitations of letter orders.

All of the various requests for special relief arising in connection with terminated contracts raise the question whether an unqualified mutual release in a settlement agreement forecloses the contractor from later obtaining such relief. The standard release specifically covers "all rights and liabilities of the parties *under* the contract and under the [Contract Settlement] Act, in so far as it *pertains to* the contract." Inasmuch as special relief is concerned with payments to which the contractor is not entitled under the terms of his contract, it may be contended that all payments by way of special relief do not arise *under* the contract, but only in *con-*

nection with it. Moreover, adopting this view, it further may be urged that special relief under section 17 of the act is a matter pertaining to the contract only *collaterally*. Applying this construction, the release may not preclude asserting a plea for extraordinary relief. This approach, however, seems unrealistically narrow in the light of commonly understood termination-settlement procedures. All signs indicate that contractors and contracting agencies consider a settlement agreement as winding up all unreserved rights and obligations whether arising under or only in connection with the terminated contract. Since the granting of extraordinary relief by the Government should rest upon a realistic basis, it is believed that this broader construction of the mutual release is to be preferred.⁷³

The occurrence of mistakes in termination settlements and agreements bears a close relationship to speed in settling contracts. The most common types of mistakes—clerical errors in settlement agreements and other failures of such instruments to express the “true agreement between the parties”—are much more apt to arise under pressure to prepare instruments within short deadlines.⁷⁴ During September, 1945, for example, in three cases settlement contracts written by the Chicago Ordnance District contained minor deviations from the agreement reached by the parties at the conclusion of negotiations. In relation to the total number of settlement agreements drafted, these intra-agency mistakes far exceeded the percentage of similar mistakes in any previous period. Sometimes errors of this nature are easily detected and corrections merely cause contractors and contracting agencies annoyance and added paper work. On other occasions, where the record of negotiations is not complete or clear, considerable time and investigation are required to ascertain the facts and make certain that the settlement instrument actually does fail to reflect accurately the negotiated agreement. In any event, a mistake in the written agreement might result in delaying payment of the contractor's termination claim in full until the error has been rectified.

Another class of mistakes which regulations provide may be corrected by the contracting agencies is designated as being composed of “mutual mistakes as to material facts.” Regulations specifically exclude from this category errors consisting of the “failure of a contractor to present or to present accurately, and of the Government to allow, a claim based on a cost incurred by the contractor or on a liability to which the contractor

⁷³ Of course, claims under section 17a of the Contract Settlement Act may arise apart from any written contract between the Government and the claimant. This is also true in the case of instructions for continued production beyond the quantity specified in an existing written contract between the parties.

⁷⁴ See Joint Termination Regulation (10-11-45) para. 748.3(1)(c).

was subject, whether by reason of ignorance of such cost or liability or of its extent or for any other reasons.”⁷⁵ As so defined, this mutual mistake concept would seem to have a very limited application. It is difficult to conceive of a mutual mistake of fact to the detriment of the contractor which would arise for reasons *other* than his failure “to present or to present accurately” a claim. On the other hand, there is no need for specific authority to permit the correction of a mutual mistake of fact which is to the detriment of the Government. Errors of this kind are correctible by contracting agencies under their broader power to amend any settlement agreement so as to benefit the Government.⁷⁶

Mistakes consisting of the “failure of a contractor to present or present accurately” a claim for his costs or liabilities pose a problem which goes to the very foundation of the concept of final settlements of terminated contracts. To allow carte blanche reopening of settlements to correct any such error would mean that every settlement potentially was partial and tentative. To bar entirely the reopening of settlements in these cases would entail working a severe hardship on contractors even under circumstances where the equities are heavily in their favor. Consequently, a compromise has had to be worked out. A contractor’s omission may be rectified only with the approval of the top administrative body of the service involved. These organizations have adopted the policy that a contractor’s failure to present, or to present accurately, a claim will be repaired only in a very limited class of cases. A positive commitment of granting relief has been given only where “it clearly appears that a contractor has been misled to his substantial detriment by actions of Government personnel on which he is entitled to rely.” Otherwise settlements will be reopened “only in the most unusual cases.”⁷⁷

Attempts may be made by contractors to predicate the reopening of final settlement agreements upon the “mistakes” of contracting agencies in refusing to allow certain components of the contractors’ claims. It might be asserted, for example, that the contracting agency arbitrarily rejected an item in the claim, perhaps by virtue of an error in applying regulations. Such circumstances, even if demonstrated, cannot be considered as infusing a *mistake* into the settlement agreed to by the parties and formalized in an executed instrument. Regardless of whether the con-

⁷⁵ Ibid.

⁷⁶ Ibid, para. 748.3(1)(a).

⁷⁷ Ibid, para. 748.2. “Adoption of any other policy would cause administrative confusion, would greatly impair the utility of the negotiated settlement, and would violate the statutory objective of finality of settlements.”

tracting agency ruled correctly on the disputed element of the claim, the contractor accepted its decision and carried the settlement through to completion. The contractor cannot be heard to complain later about the ruling on any isolated issue which formed part of a negotiated settlement, inasmuch as the entire "deal" must be considered as a whole and strictness in one aspect may have been offset by liberality in another. If the contractor felt aggrieved over the strict ruling, he should have objected—and protected his rights—before signing the settlement agreement.

While mistakes in settlements are part of the more immediate aftermath of contract terminations, frauds in settlements are likely to be aspects arising out of later, after-the-fact, investigations. For that reason, a full discussion of fraud must await the judgments of hindsight in whatever climate of opinion then exists. At present, based on facts already uncovered, it can only be said that few, if any, termination settlements have been tainted with actual fraud. None as yet has been turned up in the Chicago Ordnance District, and apparently this condition is representative. The Director of Contract Settlements on October 11, 1945, stated publicly that: "The fact is that, except for a few small borderline cases, weeded out by the contracting agencies, shyster claims just have not existed."

This is not to be construed, however, as meaning that subsequent appraisals of settlements will give contracting agencies a clean record. Already legislative investigating groups and the General Accounting Office are probing into closed terminations. In the Chicago Ordnance District alone an average day finds five representatives of the General Accounting Office reviewing settlement files. As was the case after World War I, these investigations probably will turn up very few situations involving actual fraud.⁷⁸ But who can predict whether the reviewers, following the precedent after World War I, will shout that the contracting agencies made hasty settlements involving unconscionable waste of public funds?⁷⁹

⁷⁸ For a summary of developments at the end of the last War, see Gromfine and Edwards, *Terminations after World War I*, 10 *Law and Contemporary Problems* 563, at 588 (1944).

⁷⁹ Perhaps a glimpse into the future and an indication of the ease with which wartime liberality may be confused with illegality is provided by the following excerpts from Hearings before Subcommittee No. 3 of the House Committee of the Judiciary on H. R. 4789 and S. 1718, 78th Cong., 2d Sess., at 198, 209 and 210:

"Mr. Warren. [Comptroller General] Well, the whole question is one of such magnitude. There have been so many illegal approvals made under these [cost-plus-a-fixed-fee] contracts, and there has been such laxity on the part of contracting officers, aided and abetted by those in authority in the departments. That is why I say that there should be some final check.

"Mr. Bates. You made incriminating statements about the efforts to have these payments made illegally. You followed that up by making the further statement that the tragedy of all

Though such attacks will be irritating to termination officials and may be embarrassing to contractors, the Contract Settlement Act provides that settlements shall be "final and conclusive except . . . for fraud." Regardless of its liberality, a criticized settlement apparently can be upset through court action only upon presentation of evidence that it was induced by or tainted with fraud.

To the extent this analysis serves to focus attention on generally unnoticed aspects of termination procedures it may assist in avoiding or disposing of the most common loose ends in settlements. While a number of the ramifications have been explored, the passage of time alone will completely reveal the gamut of reserved problems, ancillary negotiations, and time-consuming controversies which will follow in the wake of speedy termination settlements.

this is that apparently it is something that nobody cares anything about. Do you mean to intimate that high-ranking officials in the Government service, having charge of these administrative orders, care nothing about these illegal acts?

• • • • •
 "Mr. Warren. Oh now, I am afraid you are getting me wrong.

"Mr. Bates. You say there is apparently nobody who cares about the waste, illegal expenditures, and approval of bills, and that you are met with a shrug of the shoulders. What other intimations do you want to leave with the committee?

"Mr. Warren. Frankly, I do not know if anybody cares anything about it.

"Mr. Bates. Then, they are satisfied with corruption and waste?

"Mr. Warren. No; I would not and do not say corruption.

"Mr. Bates. Illegal payments?

"Mr. Warren. I said extravagance and waste.

"Mr. Bates. And illegal payments?

"Mr. Warren. Extreme liberality."