

1957

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Recommended Citation

John W. Whelan, *Government Supply Contracts: Progress Payments Based on Costs; The New Defense Regulations*, 26 Fordham L. Rev. 224 (1957).

Available at: <https://ir.lawnet.fordham.edu/flr/vol26/iss2/3>

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GOVERNMENT SUPPLY CONTRACTS: PROGRESS PAYMENTS BASED ON COSTS; THE NEW DEFENSE REGULATIONS

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ON DECEMBER 17, 1956, the Departments of the Army, Navy, and Air Force issued new "Defense Contract Financing Regulations" covering guaranteed loans, advance payments, and progress payments.¹ This regulation, particularly the section dealing with progress payments, has been long in preparation and, because of its importance to both Government and industry, deserves more notice among members of the bar than it has perhaps received. A discussion of progress payments under this regulation, that is, payments made on the basis of costs incurred as the work progresses on a contract (and not payments for deliveries or for services rendered), will be the purpose of this article. The author will analyze: the place of progress payments among the currently authorized methods of contract financing; existing authority for making progress payments and pertinent statutes; policies and procedures relating to their use; and the more important provisions of the new progress payment clauses under which the rights of the contractor and the Government are to be determined.

Readers should note some collateral developments of importance in connection with progress payments. On August 7, 1956, the Cabinet Committee on Small Business presented to President Eisenhower its First Progress Report containing a series of recommendations for solution of the problem of maintaining small business as a healthy member of a healthy economy. Recommendation Number 6 of the Committee pertained to progress payments and proposed:

"That the President direct departments and agencies engaged in extensive procurement to adopt procedures which would insure that a need for advance or progress

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1. This regulation (issued as Army Regulations No. 715-6, NAVEXOS No. P-1006, Air Force Regulation No. 173-133) supersedes the regulation "Defense Contract Financing" (Army Special Regulations No. 715-35-5, NAVEXOS No. P-1006, Air Force Regulation No. 173-133) dated March 17, 1952, 32 C.F.R. §§ 82.1-60 (1954). The new regulation was promulgated in the Federal Register on Feb. 9, 1957, 22 Fed. Reg. 815 and will form 32 C.F.R. §§ 82.1-74. Throughout this article, citations to the paragraphs of the regulation are given together with the citation to the Federal Register. Paragraph 510.1, the Total Costs Clause of the new regulation, is reproduced in an Appendix to this article, *infra* pp. 263-65. Readers should note that Appendixes to the Defense Contract Financing Regulations (hereinafter DCFR) contain several important Department of Defense Directives (hereinafter DoD Directives), which the Regulations implement. These Directives will be cited throughout by their file number and page number in the Federal Register.

payments by a bidder will not be treated as a handicap in awarding a contract, and which would facilitate the making of such progress payments as may be requested by small suppliers under Government contracts."²

Prompted by the President's interest in seeing this recommendation carried into effect, the General Services Administration, after consultation with other Government agencies and in cooperation with the Department of Defense, issued its Personal Property Management Regulation Number 33 on December 31, 1956.³ This regulation, applicable throughout the executive departments, prescribes basic policies and procedures for progress payments under fixed-price contracts for supplies and nonpersonal services. A most important fact to observe is that the regulation can be expected to have the effect of making progress payments more easily available throughout the entire procurement structure of executive departments.

While these developments will not be discussed *in extenso* in this article, it should be pointed out that the Defense Contract Financing Regulations (with which this paper *will* concern itself) implement Recommendation Number 6, *supra*, and reflect the basic policies stated in the General Services Administration regulation.

I. METHODS OF FINANCING

Speaking generally, the method by which one party to a contract finds the money he needs to perform his obligations is his own concern. This is as true of the seller of supplies as it is of the buyer. Thus, a contractor who agrees to manufacture bicycle pedals has to find the funds out of which he will acquire materials and parts and out of which he will meet his payrolls. Certainly, however, the ability of the seller to obtain such funds is of material importance to the buyer whose prospects of receiving performance increase or diminish with the financial responsibility of the seller.

Because it is engaged in vast purchase programs as buyer, one of the legitimate concerns of the Department of Defense is assurance of the financial responsibility of its suppliers. An effort is made, prior to the award of contracts, to investigate the capabilities of contractors with a view to ascertaining financial capacity or credit and, in addition, techni-

2. Progress Report, p. 6. The Cabinet Committee was established by the President on May 31, 1956, for the continuing task of "making specific recommendations to me for administrative actions, and where necessary for additional legislation, to strengthen the economic position of small businesses and foster their sound development."

3. CCH Gov't Contracts Rep. ¶ 24,875-80. Instrumental in developing the General Services Administration regulation cited in the text was the Task Force for Review of Government Procurement Policies and Procedures. This Task Force was constituted pursuant to Recommendation No. 5 of the Cabinet Committee on Small Business.

cal skill, managerial competence, plant capacity and facilities for the purpose of obtaining assurance that contractors will fulfill their contracts in compliance with the terms thereof.⁴

But the very complexity and size of some defense contracts indicate that, in many cases, the normal expectation of a buyer that he may rely on his seller's financial capabilities is out of place. Department of Defense policy recognizes this:

"The providing of funds for payment of expenses of performance of contracts is an essential element of defense production. Contract financing is to be regarded as a useful working tool that may be used to the benefit of the Government, for aiding procurement by expediting performance of defense contracts and subcontracts. The contract financing system makes possible production in volume that could not be accomplished otherwise. Prudent contract financing supports procurement and production and fosters the small business policy by providing necessary funds to supplement other funds available to contractors for contract performance."⁵

To provide a setting for this article on some of the legal aspects of "Progress Payments" under Defense Department contracts, a short outline of the principal methods of financing contracts will be useful.

A. *Private*

Private Financing, that is financing by use of the contractor's own funds or by means of loans from the usual commercial sources, is the first method. Since 1940, contractors have been able to assign their claims for moneys due or to become due under contracts with the Government to "a bank, trust company, or other financing institution, including any Federal lending agency."⁶ Under such an assignment, moneys due the contractor are paid directly to his assignee who is free to collect sums due on loans made by the assignee, before remitting the balance to the contractor.

B. *Private with Government Guaranty*

In this second method the Government guaranties loans made by ordinary commercial lending agencies to contractors. Commonly called "V-loans,"⁷ these loan guarantees are today authorized, as far as defense contracts are concerned by the provisions of section 301 of the Defense Production Act of 1950, as amended.⁸ The arrangement does not in-

4. See Armed Services Procurement Regulation (hereinafter ASPR), 1-307 (May 28, 1956), CCH Gov't Contracts Rep. ¶ 29,037; DCFR ¶ 204, 22 Fed. Reg. 817 (1957).

5. DCFR ¶ 202, 22 Fed. Reg. 817 (1957).

6. 31 U.S.C.A. § 203 (1954) and 41 U.S.C.A. § 15 (1952) are authority for such assignments. See Nichols, Assignment of Claims Act of 1940, 12 U. Pitt. L. Rev. 538 (1951).

7. So named after Regulation V of the Federal Reserve System Board of Governors, 32A C.F.R. c. XV (1956).

8. 50 U.S.C.A. App. § 2091 (Supp. 1956); implemented in DCFR pt. II, 22 Fed. Reg. 817 (1957).

volve a loan of government money to a contractor. A contractor, subcontractor, or other person or firm eligible for a guaranty⁹ arranges with his own lending agency or bank for a loan to finance¹⁰ his defense contract. The military department concerned¹¹ secures the assistance of the federal reserve system as fiscal agent¹² in making an agreement whereby the Government stands ready, on demand of the lending institution, to purchase a stated portion of the loan or to share losses within the amount of the guarantee percentage.¹³

C. Progress Payments

These are payments of part of the contract price as the work progresses, but in advance of delivery of supplies or performance of service under the contract. Such payments may be based on costs incurred by the contractor in pre-delivery work, on the percentage of completion achieved at the time the payment is made, or on the contractor's having reached a particular stage of performance. Such payments are obviously of material benefit to contractors because they release some part of working capital for other uses. Because progress payments based on costs under Defense Department contracts are the principal subject of this article, further discussion will be postponed.

9. The class of eligible persons or firms is quite broad and includes: "any contractor, subcontractor, or other person in connection with the performance of any contract or other operation deemed by the guaranteeing agency to be necessary to expedite production and deliveries or services under Government contracts for the procurement of materials or the performance of services for the national defense, or for the purpose of financing any contractor, subcontractor, or other person in connection with or in contemplation of the termination, in the interest of the United States, of any contract made for the national defense . . ." 50 U.S.C.A. App. § 2091(a) (Supp. 1956).

10. Guaranteed loans are primarily for working capital and are not to be used for facilities expansions. DCFR § 203, 22 Fed. Reg. 817 (1957); DoD Directive 7800.2, March 12, 1954, 22 Fed. Reg. 836 (1957).

11. Called "guaranteeing agencies" 50 U.S.C.A. App. § 2091(A) (Supp. 1956). Guaranteeing agencies include the Army, Navy and Air Force and also the Atomic Energy Commission, the Department of Commerce, the Department of the Interior, the Department of Agriculture and the General Services Administration. § 301, Exec. Order No. 10480, 18 Fed. Reg. 4941 (1953), as amended by § 1, Exec. Order No. 10574, 19 Fed. Reg. 7249 (1954). For procedures and policies in connection with applications for guaranty, see DCFR ¶ 303-06, 22 Fed. Reg. 818 (1957).

12. The functions of the Federal Reserve System are stated in § 301 of the Defense Production Act, 50 U.S.C.A. § 2091(b) (1951), Regulation V of the Board of Governors of the Federal Reserve System, 32A C.F.R. c. XV (1955) and in DCFR ¶ 301-03, 22 Fed. Reg. 818 (1957). A form V-loan guaranty agreement is set forth at DCFR App. 6 (not reprinted in the Federal Register).

13. 100 per cent guaranties are limited to the greatest extent compatible with the national defense. Generally guarantees are limited, in accordance with a formula, to amounts which do not exceed 90% or other specified percentage of the borrower's investment in defense production contracts. DCFR ¶ 307-03, 22 Fed. Reg. 819 (1957).

D. Advance Payments

Advance Payments are payments of part of the contract price in advance of any performance by the contractor. As the regulations¹⁴ put it, such payments are made "prior to, in anticipation of, and for the purpose of complete performance." Because of the obvious risk of loss of appropriated funds (for example, where the contractor never renders any performance), advance payments are made available on a restricted basis and when certain minimum assurance of satisfactory use of the payments is given. This subject will be developed more fully in connection with the discussion of Revised Statutes, section 3648, *infra*.

With the exception of progress payments in certain cases,¹⁵ the methods of financing listed above are given in the order in which the Department of Defense prefers that they be used.¹⁶ That is, for general purposes, progress payments are preferred to advance payments, private financing with government guaranty is preferred to either of them, and first preference is given to private financing either with or without assignment of claims.

In addition to the methods discussed above, certain other sources of financial assistance to contractors are available. Because of the limited scope of this article, discussion of these methods is confined to a brief note.¹⁷

14. DCFR ¶ 104, 22 Fed. Reg. 816 (1957).

15. "Customary" progress payments will be discussed *infra*.

16. DoD Directive, 7800.1, pt. III, Oct. 30, 1953, 22 Fed. Reg. 834 (1957). For an excellent analysis of Defense Department contract financing policies and procedures, see Bachman, Defense Department Contract Financing, 25 Geo. Wash. L. Rev. 228 (1957).

17. (1) Small business may obtain financial assistance from the Small Business Administration pursuant to the authority granted the Administration by 15 U.S.C.A. § 636 (Supp. 1956):

"(a) The Administration is empowered to make loans to enable small-business concerns to finance plant construction, conversion, or expansion, including the acquisition of land; or to finance the acquisition of equipment, facilities, machinery, supplies, or materials; or to supply such concerns with working capital to be used in the manufacture of articles, equipment, supplies, or materials for war, defense, or essential civilian production or as may be necessary to insure a well-balanced national economy; and such loans may be made or effected either directly or in cooperation with banks or other lending institutions through agreements to participate on an immediate or deferred basis . . ." Certain limitations on such loan power are stated in 15 U.S.C.A. §§ 636(b), 648 (Supp. 1956). Authority to make such loans terminates, under current authority, on July 31, 1957, pursuant to 15 U.S.C.A. § 650 (Supp. 1956).

(2) Pursuant to 50 U.S.C.A. App. § 2092 (Supp. 1956), the President is authorized, in order "to expedite production and deliveries or services to aid in carrying out Government contracts for the procurement of materials or the performance of services for the national defense . . ." to provide for loans, loan participations and guaranties to private business enterprises. These loans are for: "the expansion of capacity, the development of technological processes, or the production of essential materials . . ." Authority under this section

II. PROGRESS AND ADVANCE PAYMENTS

A. *Fiscal Restraints on Executive Agencies*

It is obvious from even so short a discussion as the preceding one that advance and progress payments are advantageous to contractors. Such payments enable contractors to use for other purposes working capital that otherwise they might have to devote to government contracts. Advance payments bear interest and are secured.¹⁸ Current practice makes progress payments singularly advantageous. Progress payments do not bear interest nor is the contractor required to give bond to secure their repayment. Perhaps for these reasons, progress payments are "the largest single segment of contract financing in the Department of Defense."¹⁹

But without more, there is no equivalent advantage to the Government from the mere making of progress or advance payments unless it be the possibility of expediting performance of contract duties by contractors or the likelihood that bidders may reduce their prices. Patent is the possibility that appropriated funds so made available to contractors may never be returned in the form of contract performance, whether by reason of the contractor's default, levy by his creditors, or other cause. Recognition of the possibility of this painful mischance gave rise to Revised Statutes, section 3648 which, as amended,²⁰ provides in part:

"No advance of public money shall be made in any case unless authorized by the appropriation concerned or other law. And in all cases of contracts for the performance of any service, or the delivery of articles of any description, for the use of the United States, payment shall not exceed the value of the service rendered, or of the articles delivered previously to such payment."

In many cases, literal enforcement of so broad a prohibition as the "no advance" mandate in the first sentence of the statute has proved undesirable. Thus, in addition to the exemption of advances contained in appropriation acts from time to time,²¹ a number of express exceptions

is available until June 30, 1958, pursuant to 50 U.S.C.A. App. § 2166(a) (Supp. 1956). The President has delegated his authority to make the loans authorized by 50 U.S.C.A. § 2092 (Supp. 1956) to the Secretary of the Treasury. The essentialness of such loans must be certified by the Director of the Office of Defense Mobilization. Exec. Order No. 10480, 18 Fed. Reg. 4939, 4942 (1953), as amended by Exec. Order No. 10489, 18 Fed. Reg. 6201 (1953).

18. See DoD Directive 7830.1, ¶ III A, B, May 31, 1956, 22 Fed. Reg. 836 (1957); DCFR ¶ 402, 22 Fed. Reg. 821 (1957); ASPR 3-504, 3-405 (Sept. 7, 1956), CCH Gov't Contracts Rep. ¶ 29,164-65. See 10 U.S.C.A. § 2307 (Rev. 1956).

19. See Bachman, *supra* note 16, at 229.

20. 31 U.S.C.A. § 529 (1952).

21. E.g., 31 U.S.C.A. § 529(i) (Supp. 1956). This section is permanent in its application to Department of Defense Appropriation Acts, replacing the recurring provision found in

from the statute have been created by "other law."²² Further exceptions are recognized in the omitted portions of Revised Statutes, section 3648.²³

It is clear that at least one type of contract payment is permitted by the statute. Thus, when the contractor has delivered part of the articles or performed part of the services under his contract and the Government has accepted them, he may be paid the contract price for such performance. For example, the contractor who has contracted to manufacture and deliver one hundred motors at \$300 each is entitled to payment of \$3,000 for the delivery of his first ten motors, if they are acceptable. Such payments are expressly authorized by the "Payments" clause, which is a standard part of fixed-price supply contracts.²⁴ Payments of this kind are correctly referred to as "partial" payments.²⁵

But it is equally clear that progress and advance payments are within the apparent prohibition of Revised Statutes, section 3648. Other examples of payments within the apparent prohibition of the act might be added: for instance, "partial" payments on termination claims under the "Termination for the Convenience of the Government" clause;²⁶ payments as the work progresses under construction contracts;²⁷ payments of costs at periodic intervals under cost-reimbursement supply contracts.²⁸

Department of Defense Appropriation Acts for preceding years: § 702 of the 1955 Appropriation Act, 68 Stat. 349, § 602 of the 1954 Appropriation Act, 67 Stat. 349, § 602 of the 1953 Appropriation Act, 66 Stat. 531.

22. See, *inter alia*, 31 U.S.C.A. §§ 529(a)-(c),(f),(h), 530, 532-36, 539, 550 (1954); see also 23 U.S.C.A. § 161 (Supp. 1956).

23. The omitted sentences of Rev. Stat. § 3648, as amended, permit the President to direct advances to government disbursing officers and also to persons in the military and naval service on distant stations.

24. ASPR 7-103.7 (April 30, 1956), CCH Gov't Contracts Rep. ¶ 29,363.

25. See ¶ 2a, Personal Property Management Regulation No. 33, issued by the General Services Administration Dec. 31, 1956, CCH Gov't Contracts Rep. ¶ 24,875; DCFR ¶ 509.1, 22 Fed. Reg. 826 (1957). In the past the term "partial payment" has been used to describe what now is consistently called "progress payment."

26. See ASPR 8-701(j) (April 4, 1955), CCH Gov't Contracts Rep. ¶ 41,861. Such payments may be made upon the basis of the contractor's completed items and termination inventory without these items and inventory being delivered to the Government. ASPR 8-522.4 (Jan. 3, 1955), CCH Gov't Contracts Rep. ¶ 41,822.4, requires protection of the interest of the Government by transfer of title to the Government or creation of a paramount lien in favor of the Government on such items or inventory or by "other means." Insofar as title is transferred or a lien created, this sort of partial payment would not appear to violate Rev. Stat. § 3648. See discussion, *infra*, p. 231.

27. See art. 7, U.S. Standard Form 23A, revised March 1953, CCH Gov't Contracts Rep. ¶ 18,202. Article 7 permits payments to be made to a construction contractor at the end of each month as the work progresses. All material and work covered by such payments, including materials delivered on the site and preparatory work, becomes the sole property of the Government. This would not appear to violate Rev. Stat. § 3648. See discussion, *infra*, p. 231.

28. See ASPR 7-203.4 (Jan. 3, 1955), CCH Gov't Contracts Rep. ¶ 29,371. This clause

B. Current Authority for Progress and Advance Payments

Revised Statutes, section 3648 finds its genesis in the Act of January 31, 1823.²⁹ With some changes in terminology,³⁰ the statute has come down to this day virtually intact in language. Some statutory exceptions have been made, as noted previously.³¹ The purpose of this statute is not hard to find. It is natural for those who hold the public purse strings and appropriate the public money for expenditure to desire that no expenditure be made without concurrent receipt of something to show for it.³² Despite the literal wording of the statute, requiring the delivery of articles or the performance of services, a long series of holdings by the Attorney General and the accounting officers of the Government, unobjected to by Congress,³³ has established that payments under con-

permits contractors to be paid allowable incurred costs on a monthly or more frequent basis. However, to the extent such costs cover property acquired by the contractor for contract performance, title to such property will vest in the Government. ASPR 13-503 (April 27, 1955), CCH Gov't Contracts Rep. ¶ 29,744 contains a "Government Property" clause required to be inserted in cost-reimbursement supply contracts; this clause provides for such title-vesting.

29. 3 Stat. 723 (1823).

30. Some technical amendments were included in the 1875 revision of statutes, Rev. Stat. § 3648. The Act of Aug. 2, 1946, 60 Stat. 809, added the words "unless authorized by the appropriation concerned or other law" to the first sentence. The legislative purpose was "merely to sanction the incorporation of exceptions in appropriation acts as may be required from time to time without raising the question of a point of order." H.R. Rep. No. 2186, 79th Cong., 2d Sess. 7 (1946).

31. See note 22 *supra*.

32. The summary of debates on the bill which became the Act of Jan. 31, 1823, 3 Stat. 723, make interesting reading. The remarks of Mr. Bassett of Virginia, the proponent and Mr. Newton of Virginia, the chief opponent, are found at 40 *Annals of Cong.* 336, 391 (1822-23). Apparently Mr. Bassett felt that advances to contractors were unjustified in any case because they could borrow money on the strength of their government contracts. Mr. Newton felt that this would eliminate from among the persons who might contract with the Government all except those who had a surplus of capital and who would make the Government pay as high as possible. Neither gentleman specifically commented on payments as work progresses under contracts, though one suspects that Mr. Newton would be sympathetic and Mr. Bassett antipathetic.

33. That Congress knew of these holdings is evident. (See note 34, *infra*.) In 1911, the legality of payments by the Navy as the work progressed on the construction of naval vessels was questioned. The Navy acquired a lien on the uncompleted vessels in return for such payments, in the belief that this effected compliance with Rev. Stat. § 3648. Congress, however, had before it a proposal to eliminate from the Naval Appropriations Act for 1912 a provision authorizing the Navy to make partial payments on certain vessels. The problem was whether such elimination would preclude the making of such "partial" or "progress" payments or whether Rev. Stat. § 3648 would permit them independently. The Secretary of the Navy believed that Rev. Stat. § 3648 would, but nonetheless he requested that any doubt be removed. The Attorney General expressed his opinion that such payments were authorized under Rev. Stat. § 3648 but concurred that elimination of the

tracts may be made where the United States receives an equivalent benefit therefor in the form of transfer of title to contract materials or work in progress, or a paramount lien against such items.³⁴

appropriation provision might result in embarrassment to the Navy. Accordingly, Congress, to remove all doubts, passed the Act of Aug. 22, 1911, 37 Stat. 32, formerly 34 U.S.C.A. § 582 (1952) and now 10 U.S.C.A. § 7521 (Rev. 1956). The purpose of the Act seems to have been to confirm the legality of the Navy's practice of making progress payments in return for a lien. See 47 Cong. Rec. 578 (1911); H.R. Rep. No. 39, 62d Cong., 1st Sess. 4-6 (1911); 29 Ops. Att'y Gen. 46 (1911).

In 1941, the War Department found itself in the position of having to require bonds of its supply contractors who had received progress payments and transferred title to work in progress in return for such payments. The reason for this may be found in the opinions of the Comptroller General and Attorney General, holding that such title-vested work became a public work of the United States and that, therefore, the requirements of the Miller Act, 40 U.S.C.A. § 270(a)-(d) (1952), that the contractor secure payment and performance bonds applied. In hearings before the House Committee on the Judiciary, Judge Patterson, then Undersecretary of War, commented that this reasoning led to the conclusion that a contract for undershirts might become a contract for a public work. This he thought was "pretty thin" in view of the fact that the Miller Act was primarily directed toward contracts for construction of public buildings and the like. See Hearings Before Subcommittee No. 4 of the House Judiciary Committee, 77th Cong., 1st Sess. ser. 4, p. 6 (1941). To relieve this situation, Congress enacted the Act of April 29, 1941, 40 U.S.C.A. § 270(e) (1952), which authorized the waiver of the bond requirement "with respect to contracts for the manufacturing, producing, furnishing, construction, alteration, repair, processing, or assembling of vessels, aircraft, munitions, materiel, or supplies of any kind or nature for the Army or the Navy, regardless of the terms of such contracts as to payment or title" This seems to indicate congressional approval of the known practice of making progress payments in return for title to the work in progress.

On the effect of long-continued administrative interpretations, known and unobjected to by the legislature, see 2 Sutherland, *Statutory Construction* §§ 5105, 5108, 5109 (particularly at p. 525) (3d ed. 1943).

34. Pertinent decisions of the Attorneys General and government accounting officers include: 29 Ops. Att'y Gen. 46 (1911); 21 Ops. Att'y Gen. 12 (1894); 20 Ops. Att'y Gen. 746 (1894); 18 Ops. Att'y Gen. 105 (1885); 18 Ops. Att'y Gen. 101 (1885); 28 Comp. Gen. 468 (1949); 20 Comp. Gen. 917 (1941); 1 Comp. Gen. 286 (1921); 1 Comp. Gen. 143 (1921); 17 Comp. Dec. 894 (1911). It is also worthy of passing note that the Comptroller General has ruled that federal contracts with the states or local political units are not within the prohibition of Rev. Stat. § 3648. The reason behind this rule is that the statute was directed primarily against the danger of loss of appropriated funds due to a contractor's default, and that the established responsibility of state and local government agencies and officials reduces to the minimum any possibility of loss to the United States. Ms. Comp. Gen. Dec. B-118846, March 29, 1954; Ms. Comp. Gen. Dec. B-109485, July 22, 1952. Should additional authority be looked for, it may colorably be argued that § 5 of the Armed Services Procurement Act, now 10 U.S.C.A. § 2307 (Rev. 1956) authorizes payments in advance of delivery and thus justifies progress payments. The section specifically relates to "advance" payments and, in view of the well-established functional and procedural differences between advance and progress payments, the section should be regarded as related only to the former. In any event, progress payments seem able to be sustained without regard to specific authorizing statutes, if one gives the Attorney General and

Prefatory to examination of current policies and practices with respect to progress payments, it should be observed that the prohibition of Revised Statutes, section 3648, insofar as it pertains to contract advance and progress payments has been expressly relaxed by certain statutes.

1. Progress Payments

Pursuant to title 10, section 7521 of the United States Code, as revised in 1956,³⁵ the Secretary of the Navy is authorized to make contracts containing "partial" payment provisions, that is, provisions allowing payments to be made as the work progresses. When a contract contains such an authorizing provision, payments may be made not exceeding the value of the work done. The statute requires that contracts permitting such payments shall contain a provision to the effect that, when a partial payment is made, a lien on the thing contracted for accrues to the United States because of the payments so made. The statute also requires that the contract provide this lien be paramount to all other liens. Although this statute relates to payments similar, if not identical, to "progress" payments of the type discussed in this article, and although it seems to command that a lien be acquired, current regulations do not require the lien provision in all Navy contracts calling for progress payments.³⁶ Instead, fixed-price supply contracts of the Army, Navy and Air Force calling for progress payments based on costs will provide for the acquisition of title to parts, materials and certain other property acquired or produced by the contractor for performance.³⁷

Comptroller General decisions cited earlier in this note their obvious import. This is not true of advance payments, at least in those circumstances where the advance payment is made before the contractor does any work or incurs any costs or purchases any materials. In such cases, the title or lien escape from Rev. Stat. § 3648 is not available and statutory authority for the payments clearly necessary.

35. For the origin of this act see note 33 supra.

36. The requirements of DCFR, pt. V, 22 Fed. Reg. 826 (1957), including the requirement that contracts providing for progress payments based on costs contain title-vesting clauses (*id.* at ¶ 510, 22 Fed. Reg. at 827), extend to all Defense Department contracts allowing progress payments except cost-reimbursement contracts, contracts for construction, and contracts for shipbuilding or ship conversion, alteration or repair. *Id.* at ¶ 500.2, 502, 22 Fed. Reg. at 826. Noteworthy is the fact that the Navy Department Bureau of Ships "Vessel Form" contract (Sept. 1953) provided for acquisition of both a lien against, and title to, the vessel and materials and equipment acquired therefor. The lien provided for in art. 12 of this contract is the one prescribed by the Act of August 22, 1911, 10 U.S.C.A. § 7521 (Rev. 1956). Navy Contract Law 92 (1949), (Bureau of Naval Personnel document 10841, 1949, prepared by the Office of the General Counsel of the Navy), indicates that either title or a lien will satisfy the statute.

37. See DCFR ¶ 500.2, 502, note 36 supra; ¶ 510.1(d). "Title" will be discussed more fully *infra*.

2. Progress and Advance Payments

(a) Title 10, section 7522 of the United States Code, as revised in 1956,³⁸ exempts Navy contracts "for services and materials necessary to conduct research and to make or secure reports, tests, models or apparatus" from the prohibition of section 3648 of the Revised Statutes insofar as it applies to advance, progress or other payments.

(b) Section 201, title II, First War Powers Act, as amended and several times extended by Congress,³⁹ empowers the President to authorize the defense agencies " . . . to enter into contracts and into amendments or modifications of contracts . . . and to make advance, progress or other payments thereon, without regard to the provisions of law relating to the making, performance, amendment, or modification of contracts whenever he deems such action would facilitate the national defense" Executive Order Number 10210⁴⁰ extends this authority to the Department of Defense and to the Secretaries of the Army, Navy and Air Force. Although this statute on its face gives very nearly *carte blanche* with respect to contracts, it is relied on by the Department of Defense principally in only a few categories of contract actions and does not appear to be used as a basis for making progress payments.⁴¹

(c) Applicable to payments (and, of course, to payments under contracts) made from appropriations to the Department of Defense are the permanent provisions of section 602 of the Department of Defense Appropriation Act, 1956,⁴² stipulating that Revised Statutes, section 3648 shall not apply: (1) when such payments are made in compliance with

38. Based on § 6 of the Act of Aug. 1, 1946, 60 Stat. 780, 5 U.S.C.A. § 475(e), which is repealed by § 53b of the Act of Aug. 10, 1956, 70A Stat. 641, 675.

39. 50 U.S.C.A. App. § 611 (Supp. 1956). The Act of June 1, 1955, 69 Stat. 82, extended the automatic expiration date of tit. II until June 30, 1957. One of the legislative purposes in enacting § 201, tit. II was to facilitate the making of progress payments. See H.R. Rep. No. 1507, 77th Cong., 1st Sess. 2 (1941). See McClelland, Administration Of Title II Of The First War Powers Act, 61 Dick. L. Rev. 215 (1957).

40. 16 Fed. Reg. 1049 (1951), which also extended authority to the Department of Commerce. Later Executive Orders have extended authority to the Department of Agriculture, the Atomic Energy Commission, the National Advisory Committee for Aeronautics, and the Government Printing Office (Exec. Order No. 10216, 16 Fed. Reg. 1815 (1951)); the General Services Administration (Exec. Order No. 10227, 16 Fed. Reg. 2675 (1951)); the Tennessee Valley Authority (Exec. Order No. 10231, 16 Fed. Reg. 3025 (1951)); the Federal Civil Defense Administration (Exec. Order No. 10243, 16 Fed. Reg. 4419 (1951)); and the Department of the Interior (Exec. Order No. 10298, 16 Fed. Reg. 11135 (1951)). With the abolition of the Defense Materials Procurement Agency, its authority to act was transferred to the Office of Defense Mobilization, Exec. Order No. 10461, 18 Fed. Reg. 3513 (1953).

41. See Army Procurement Procedure 30-401, 30-402 (June 11, 1956), CCH Gov't Contracts Rep. ¶ 21,752-53.

42. 31 U.S.C.A. § 529(i) (Supp. 1956).

the laws of foreign countries or their ministerial regulations; (2) when such payments are for rent in foreign countries for such periods as may be necessary to accord with local custom; or (3) when such payments are for tuition.

3. Advance Payments

(a) Section 2307(a) of title 10, United States Code, as revised in 1956,⁴³ permits advance payments (not in excess of the contract price) to be made on negotiated⁴⁴ contracts in cases where the contractor gives adequate security⁴⁵ and the agency head (that is the secretary, under-secretary, any assistant secretary of one of the military departments or the Secretary of the Treasury or the Executive Secretary of the National Advisory Committee on Aeronautics)⁴⁶ determines that advance payments are in the public interest or the interest of the national defense and are necessary for the procurement of property or services under the

43. This section is derived from 41 U.S.C.A. § 154(a) (1952), which it replaces. World War II experience indicated the necessity for the advance payment power (1) in any period of future emergency (when it might become necessary to provide financial support to contractors with special, vitally-needed skills who might not be able to obtain credit from normal sources), and (2) in peacetime (particularly in case of research and development contracts with educational and research institutions or small business concerns which may be unable to finance research projects). See S. Rep. No. 571, 80th Cong., 1st Sess. 18 (1947); H.R. Rep. No. 109, 80th Cong., 1st Sess. 21 (1947).

44. That is, contracts which are not made pursuant to formal advertising and competitive bid procedures, 10 U.S.C.A. § 2302(2) (Rev. 1956). See ASPR 3-101 (March 26, 1957), CCH Gov't Contracts Rep. ¶ 29,106.

45. 10 U.S.C.A. § 2307(b) (Rev. 1956), based on 41 U.S.C.A. § 154(b) (1952), provides that the terms of a contract authorizing advance payments may provide for a lien in favor of the United States on: (1) the property contracted for; (2) the credit balance in any special account in which the advance payments are deposited; and (3) such material and other property acquired for contract performance as the parties may agree. If the agreement provides for this lien, then the lien will be paramount to any other lien under explicit provision in 10 U.S.C.A. § 2307(b) (Rev. 1956). Regulations implementing 10 U.S.C.A. § 2307 (Rev. 1956) may be found in DoD Directives 7800.1, Oct. 30, 1953; 7800.4, Nov. 16, 1956, 7800.2, March 12, 1954; and 7830.1, May 31, 1956. These directives are included as Appendixes 1-4 inclusive, in DCFR, 22 Fed. Reg. 815, 834 (1957). Part IV of the Regulations contains detailed instructions pertaining to advance payments, including a form agreement for a special deposit account into which advance payments are required to be paid (¶ 410.1) and standard contract provisions for insertion in contracts calling for advance payments (¶ 410.2). In general, these contract provisions stipulate the forms of security suggested in 10 U.S.C.A. § 2307(b) (Rev. 1956), *supra*; in addition, the Government may require additional security. An advance payment bond (see ASPR 10-101.4, 10-105, Nov. 8 1955) may be, but is not usually, required. (¶ 403). Additional regulations pertaining to advance payments may be found in ASPR § III, pt. 5 (Sept. 7, 1956), CCH Gov't Contracts Rep. ¶ 29,160-66.

46. "Head of an agency" is defined in 10 U.S.C.A. § 2302(1) (Rev. 1956), to include the officers mentioned in the text.

contract.⁴⁷ Section 305 of the Federal Property and Administrative Services Act of 1949, as amended, contains a substantially similar provision.⁴⁸

(b) Section 201, title II, First War Powers Act,⁴⁹ as amended and extended, mentioned above, contains broad authority with respect to advance payments and has been relied on by the Department of Defense as a basis for making advance payments on advertised contracts.⁵⁰ Thus, pursuant to section 2307(a), title 10, United States Code, and title II, advance payments are currently authorized on both negotiated and advertised contracts.

C. Policies—Progress Payments Based on Costs

Although, as noted previously,⁵¹ progress payments may be made on bases such as percentage of completion or stage of completion, the new regulation restricts the use of such progress payments.⁵² As far as Defense Department fixed-price supply contracts⁵³ are concerned, progress payments will be based on costs incurred.⁵⁴ That is, the contractor whose ultimate reimbursement is based on delivery of articles at a fixed dollar

47. Under 10 U.S.C.A. § 2311 (Rev. 1956), the named officers may not delegate the function of making such determinations. See DoD Directive 7830.1, pt. III D, note 45 supra.

48. 41 U.S.C.A. § 255 (1952). This section was taken from § 5 of the Armed Services Procurement Act, formerly 41 U.S.C.A. § 154 (1952), now 10 U.S.C.A. § 2307 (Rev. 1956). The difference between the sections lies chiefly in the language employed by the draftsman; 10 U.S.C.A. § 2307 (Rev. 1956), is a refreshing example of clear draftsmanship. Title III of the Federal Property and Administrative Services Act (of which § 305 is a part) relates to contracts made by the General Services Administration and those other executive agencies which the Administrator of General Services authorizes to act under tit. III. Congressional purpose in enacting § 305 was substantially the same as in the case of 41 U.S.C.A. § 154 (1952), supra; H.R. Rep. No. 670, 81st Cong., 1st Sess. 24 (1949). Similar restrictions on delegation of authority to make determinations supporting advance payments exist. 41 U.S.C.A. § 257 (1952).

49. 50 U.S.C.A. App. § 611 (Supp. 1956).

50. See DoD Directive 7830.1 pt. IV, May 1, 1956 and DCFR ¶ 401.1, note 45 supra. Authority to make advance payments under tit. II may be delegated to a lower echelon than permissible under 10 U.S.C.A. § 2307 (Rev. 1956).

51. See p. 227 supra.

52. Progress payments based on percentage of completion or stage of completion are restricted to contracts for construction, shipbuilding and ship conversion, alteration or repair. DCFR ¶ 502, 22 Fed. Reg. 826 (1957). See notes 27, 36-37 supra.

53. Fixed-price supply contracts, with or without provision for price redetermination, escalation, or other flexible pricing provisions (see ASPR 3-403 (April 4, 1955) CCH Gov't Contracts Rep. ¶ 29,143) will be the principal type of contract in connection with which progress payments based on costs are used. Cost reimbursement supply contracts have different provisions, see note 28 supra.

54. Definitions of "costs" and "incurred costs" are found in DCFR ¶ 509.4, 509.5, 22 Fed. Reg. 827 (1957).

amount per unit may receive progress payments based on the costs incurred prior to delivery of the articles on which they were incurred. In general, such progress payments are limited in amount to a percentage of such costs. The two standard progress payment clauses limit payments to 75 per cent of total costs and 90 per cent of direct labor and material costs, respectively.⁵⁵

It is not every fixed-price supply contractor who will readily obtain progress payments based on costs. Although such payments may be made both on advertised⁵⁶ and negotiated contracts, the contract must call for a type of production which involves a long lead time and pre-delivery expenditures which have a material effect on the contractor's working funds.⁵⁷ Further, the contractor must be known to be reliable

55. See DCFR ¶ 510.1, 510.2, 22 Fed. Reg. 827-28 (1957); DoD Directive 7840.1, pt. III, April 22, 1954, 22 Fed. Reg. 837 (1957). Variations in these percentages are permitted in unusual circumstances. See DCFR ¶ 511, 22 Fed. Reg. 828 (1957); DoD Directive 7840.1, pt. IV, April 22, 1954, 22 Fed. Reg. 837 (1957).

56. The problem in connection with formally advertised contracts is to keep all the bidders on an equal footing. Consequently, the Comptroller General has held that a low bid which included a progress payment clause, where no such provision was authorized by the invitation for bids, was not eligible for award. Award to the next low bidder, who offered unqualified compliance with the terms of the invitation was approved. Ms. Comp. Gen. Dec. B-128454, Oct. 11, 1956. However, if the invitation does authorize the bidders to include a specified progress payment clause in their bids at their election, bids including the clause may be considered for award. In such circumstances a bid including the clause will be evaluated on the same basis as a bid which does not include it. Despite the fact that a progress payment clause is a "material advantage" to a bidder, (justifying rejection of his bid where the invitation for bids does not authorize the clause, Ms. Comp. Gen. Dec. B-128454, supra), it provides no basis for a different evaluation between bids with the clause and those without it. The cost to the Government of administering the clause is too "vague and indefinite" to afford any measure of difference. 35 Comp. Gen. 282 (1955).

The Defense Contract Financing Regulations permit contracting officers to include progress payment clauses in invitations for bids only in case the contracting officer considers: "(1) that the period between the beginning of work and the required first production delivery will exceed six months, or (2) that progress payments will be useful or necessary by reason of unusual circumstances that will involve substantial accumulation of pre-delivery costs that may have a material impact on a contractor's working funds (including but not limited to substantial small-business set-asides expected to involve a relatively large pre-delivery accumulation of materials, purchased parts or components). . . ." If the contracting officer does authorize a progress payment clause in the invitation, the invitation must state that bids including requests for the clause will be evaluated on an equal basis with other bids. ¶ 507, 22 Fed. Reg. 826 (1957); DoD Directive 7800.4, pt. III D, Nov. 16, 1956, 22 Fed. Reg. 835 (1957).

57. The "lead time" or preparatory period normally approximates six months between the beginning of work and the first delivery. Examples of contracts involving such lead time and also having a material effect on the contractor's working capital are: "contracts for aircraft, engines, complex items of electrical or electronics equipment, heavy handling equipment, production machines and equipment, tanks and other items of heavy ordnance." DoD Directive 7840.1, pt. III, April 22, 1954, 22 Fed. Reg. 837 (1957).

and competent, to be capable of satisfactory performance, and to have an adequate accounting system and controls.⁵⁸ In addition, the Defense Department recommends that progress payments be discouraged on relatively small contracts of the stronger and larger producers (for example, contracts for less than \$1,000,000).⁵⁹ To the extent that these criteria are met and the progress payments requested do not exceed the 75 per cent or 90 per cent ratios stated above, progress payments are regarded as "customary" and will be provided as a matter of course.⁶⁰ Need on the part of the contractor for progress payments it not, in such "customary" cases, to be regarded as a deterrent to award.⁶¹ The Department of Defense "order of preference" in contract financing, referred to previously, is not applicable when progress payments are of this "customary" variety.⁶²

In other cases, progress payments based on costs are regarded as "un-usual" and may be provided only if special approval is given.⁶³

In some areas of government contracting small business is a preferred competitor.⁶⁴ With respect to progress payments, a degree of preference is also extended to small business. For example, the small business contractor's need for progress payment financing is not to be regarded

58. DCFR § 503, 22 Fed. Reg. 826 (1957); see also DoD Directive 7840.1, pts. III, V, April 22, 1954, 22 Fed. Reg. 837 (1957); DCFR § 518-19, 22 Fed. Reg. 831 (1957).

59. See DoD Directive 7840.1, pt. III, note 58 supra.

60. See DoD Directive 7800.4, pt. III A, Nov. 16, 1956, 22 Fed. Reg. 835 (1957); DoD Directive 7840.1, pt. III, note 58 supra.

61. See DCFR § 206, 22 Fed. Reg. 817 (1957); DoD Directive 7800.4, pt. II, Nov. 16, 1956, 22 Fed. Reg. 835 (1957). Recommendation No. 6 of the President's Cabinet Committee on Small Business was to the effect that need for advance or progress payments by a bidder must not be treated as a handicap in awarding a contract. This recommendation is worded so as to be generally applicable and not merely applicable to cases where small businesses are the bidders. The recommendation finds recognition in § 206 and DoD Directive 7800.4, pt. II supra, and also in General Services Administration Personal Property Management Regulation No. 33, CCH Gov't Contracts Rep. § 24,875. See notes 1-3 supra.

62. See DoD Directive 7800.4, pt. III A, Nov. 16, 1956, 22 Fed. Reg. 835 (1957); DoD Directive 7840.1, pt. III, April 22, 1956, 22 Fed. Reg. 837 (1957).

63. DoD Directive, 7840.1, pt. IV, April 22, 1954, 22 Fed. Reg. 837 (1957).

64. For example, award will be made to a small business bidder on a formally advertised contract in preference to a non-small business bidder (who will not perform the contract in a labor surplus area), ASPR 2-406.4 (i), (Sept. 30, 1955), CCH Gov't Contracts Rep. § 29,086. Under certain circumstances bidding on a procurement may be restricted to small business bidders. Army Procurement Procedure 30-714 (b) (April 1, 1957), CCH Gov't Contracts Rep. § 21,848. For purposes of government procurement, a small business is "a concern that (1) is not dominant in its field of operation and, with its affiliates, employs fewer than 500 employees, or (2) is certified as a small business concern" by the Small Business Administration, (Regulation of the Small Business Administration, effective Jan. 1, 1957, 21 Fed. Reg. 9709 (1956)).

as a deterrent to an award; nor is the relative smallness of the amount involved in his contract.⁶⁵ The favorable position of small business as far as progress payments are concerned, seems due in large measure to the recommendation of the President's Cabinet Committee on Small Business.⁶⁶

The benefits of progress payments are not restricted to prime contractors. Quite obviously, a prime contractor may agree with his subcontractors that he will furnish them progress payments as they incur costs under their subcontracts. Presumably such an arrangement would reflect the advantage both of the "prime" and the subcontractor. Because advantage may accrue also to the Government, prime contractors may under some circumstances, be reimbursed for progress payments made to "subs." If the "prime" has subcontractors to whom the making of progress payments may be regarded as "customary"⁶⁷ under the criteria discussed previously, the prime contractor may make such payments and, under controlled circumstances, be reimbursed by the Government up to the whole amount of payments so made.⁶⁸ These circumstances are:⁶⁹ (1) that the prime contract contain a progress payments clause and also a provision authorizing reimbursement for progress payments to subcontractors; (2) that the subcontracts under which progress payments are to be made shall include a clause substantially similar to and as favorable to the Government as the "prime's" own progress payments clause (and no more favorable to the "sub" than the "prime's" clause is to him); and (3) that such subcontract "progress payment" provision shall make the rights of the subcontractor, with

65. See DoD Directive 7800.4, pt. III A, Nov. 16, 1956, 22 Fed. Reg. 835 (1957); DCFR ¶ 208, 22 Fed. Reg. 817 (1957). As pointed out in note 61 *supra*, need for progress payments is no "handicap" or deterrent to award in case of either small and non-small business bidders. However, it is clear that small businesses are more likely than large firms to lack the working capital to carry out government contracts and the "no handicap" policy is likely to have greater impact among small businesses. This was, in fact, one of the stated reasons for Recommendation No. 6 of the President's Cabinet Committee on Small Business. (p. 6 of the pamphlet "Progress Report by the Cabinet Committee on Small Business, Aug. 7, 1956).

66. See notes 2, 65 *supra*. However, it is not apparent that, prior to this Recommendation, regulations discriminated against small business. See DoD Directive 7840.1, pt. III, April 22, 1954, 22 Fed. Reg. 837 (1957). Certainly regulations such as those cited at the beginning of note 65 *supra* clarify and emphasize the policy with respect to small business.

67. See p. 238 and note 60 *supra*. Progress payments to subcontractors in "unusual cases" may be reimbursed to the prime contractor provided such progress payments are approved as required in DoD Directive 7840.1, pt. IV, April 22, 1954, 22 Fed. Reg. 837 (1957). DCFR ¶ 512, 22 Fed. Reg. 829 (1957).

68. That is, the prime contractor is not restricted to recovery of 75% of the cost to him of the progress payment to his subcontractors. DCFR ¶ 512.1, 22 Fed. Reg. 829 (1957).

69. See DCFR ¶ 510.3, 512, 22 Fed. Reg. 828, 829 (1957).

respect to all property to which the Government has title pursuant to the subcontract,⁷⁰ subordinate to the right of the Government to require delivery to it in the event of default by the contractor or in the event of the bankruptcy or insolvency of the subcontractor.

III. THE NEW "PROGRESS PAYMENT" CLAUSES

Assuming that a contractor is one of those to whom progress payments may be made on the basis that they are "customary," just what will his contract provide? His duties, rights, and liabilities with respect to such payments will be stated in a standard contract clause prescribed by the Department of Defense in "Defense Contract Financing Regulations." For general use, there are two such clauses: one is known as the "Total Costs" clause;⁷¹ the other is known as the "Direct Labor and Materials Cost" clause.⁷² Limited variations are permitted.⁷³ Neither of these clauses, it should be noted, provides for interest on progress payments nor for a bond to protect the Government against the contractor's failure to make repayment.

The remainder of this article will be devoted to an analysis of some of the provisions of these clauses.

The first of the two clauses mentioned above, that is, the "Total Costs" clause, allows the contractor to claim,⁷⁴ in payment, 75 per cent of his total costs incurred under the contract, plus the amount of unliquidated progress payments to subcontractors, less the sum of previous progress payments. These costs include, of course, items such as direct labor, direct materials, manufacturing and production expense and general and administrative overhead.⁷⁵ Under this clause, the total amount of progress payments may not exceed 75 per cent of the total contract price, nor may the amount of unliquidated progress payments exceed a stipulated level.⁷⁶ A routine method of liquidating outstanding progress payments is provided, "by deducting from any payment under this contract,

70. For a decision upholding the effectiveness of a subcontract provision vesting title in the Government, see *Detroit v. Murray Corp.*, 234 F.2d 380 (6th Cir. 1956), cert. granted, 352 U.S. 963 (1957).

71. DCFR ¶ 510.1, 22 Fed. Reg. 827 (1957).

72. *Id.* at ¶ 510.2, 22 Fed. Reg. at 828.

73. *Id.* at ¶ 511.2-511.5, 22 Fed. Reg. at 828-29.

74. The contractor's claim is to be submitted on Department of Defense Form 1195 (Dec. 1, 1956), reproduced following DCFR ¶ 519, (not in Fed. Reg.). This form is used for submitting claims under either the "Total Costs" and "Direct Labor and Materials Cost" clause. *Id.* at ¶ 517, 22 Fed. Reg. at 831.

75. Certain costs are excluded: see subparagraph (a)(2) of the "Total Costs" clause, Appendix, *infra*.

76. See subparagraph (a)(3) of the "Total Costs" clause, Appendix, *infra*.

other than advance or progress, the amount of unliquidated progress payments, or 75 per cent of the gross amount invoiced, whichever is less."⁷⁷

The "Direct Labor and Materials Cost" clause allows the contractor to claim 90 per cent of direct labor and materials costs (or 90 per cent of either type of cost if the contract so limits progress payments) plus unliquidated progress payments to subcontractors, less previous progress payments. The clause also limits total progress payments to a stipulated percentage of the contract price; similarly, it establishes a ceiling on the amount of unliquidated progress payments. As in the "Total Costs" clause a formula for routine liquidation by deduction from amounts due for deliveries is provided.⁷⁸

Both clauses provide that progress payments "shall" be made to contractors. Until recently, the "Progress Payment" clause in use by the Department of the Army⁷⁹ stated that the Contracting Officer "may" authorize such payments. Undoubtedly, there are many contracts still under administration which contain the "may" clause. These will continue to be governed by that clause; current policy does not require that the newly promulgated clause be incorporated by amendment into existing contracts.⁸⁰

To the extent that the "may" clause produces litigation, the ruling in the "unhappy" *Lennox Metal* case⁸¹ may be followed in the courts. In

77. Subparagraph (b) of the "Total Costs" clause, 22 Fed. Reg. 827 (1957). Subparagraph (b) also prescribes the method of calculating repayments to the Government in the event of retroactive price reductions, e.g., those which might be made under price redetermination clauses, see Army Procurement Procedure 7-150.5 (Dec. 20, 1956), CCH Gov't Contracts Rep. ¶ 19,690. In the event the contract is terminated for the convenience of the Government, liquidation is handled pursuant to the "Termination for Convenience" clause, see ASPR 8-701 (c), (e), (Jan. 3, 1955), CCH Gov't Contracts Rep. ¶ 41,861.

78. See DCFR ¶ 511.7, 22 Fed. Reg. 829 (1957) for an example of this extremely complicated business.

79. This clause was still contained in Army Procurement Procedure 7-150.1 as of Dec. 20, 1956, CCH Gov't Contracts Rep. ¶ 19,690. The Air Force Procurement Instruction contains a "may" clause, AFPI 54-606(a), CCH Gov't Contracts Rep. ¶ 26,714.6. Presumably use of these clauses will be replaced in new procurement by those prescribed in DCFR ¶ 510 ("shall" clauses) as required by DCFR ¶ 514, 22 Fed. Reg. 830 (1957). The Department of the Navy for some time prescribed a "shall" clause. Navy Procurement Directives, 7-102.1 (July 20, 1956) (not in CCH), but this clause does not appear otherwise to conform to the Defense Contract Financing Regulations, except as it may be used in contract for shipbuilding or ship conversion, alteration or repair. DCFR ¶ 500.2, 22 Fed. Reg. 826 (1957).

80. *Id.* at ¶ 514, 22 Fed. Reg. at 830.

81. *United States v. Lennox Metal Mfg. Co.*, 225 F.2d 302 (2d Cir. 1955). The word "unhappy" is that of Bachman, *Defense Department Contract Financing*, 25 *Geo. Wash. L. Rev.* 228, 234 (1957). The writer of this article concurs, as apparently would Professor Pasley; see the latter's excellent article, *The Interpretation of Government Contracts: A Plea for Better Understanding*, 25 *Fordham L. Rev.* 211, 230-40 (1956). The Judge Ad-

that case, the "may" clause was viewed by the Second Circuit as meaning "shall" under the circumstances of the case, including the facts that the contractor had given consideration for the addition of the clause to his contract and that there was some evidence of Army practice not to deny such payments once the clause authorizing them was included.⁸² The point of the court's decision seemed to be that arbitrary denial by the contracting officer of a requested payment was a breach of condition by the Government excusing the contractor from further performance, and preventing the Government from insisting on delivery of title-vested property.⁸³ Whatever impact this decision will have on contracts containing the "may" clause, the newer progress payment clauses, prescribed in the Defense Department's regulation, make a virtue out of possible necessity by declaring that progress payments "shall" be made. Not that one would be anything but fatuous to say that the new wording is ascribable solely to the *Lennox Metal* decision. "Shall" undoubtedly reflects the policy of the Defense Department that, in proper cases, the making of progress payments is to be regarded as a "matter of course" when requested by contractors.⁸⁴ In any event "shall" does not free an expectant contractor from the possibility that progress payments may be reduced or suspended or the rate of their liquidation accelerated.

A. The "Reduction, Suspension or Acceleration" Provision—Subparagraph (c) of the New Clauses

Despite the fact that progress payments under the new clauses are in the "shall" category, it was not to be thought that a prudent business organization such as the Department of Defense would leave itself without some residual control over progress payments. Quite obviously, in some circumstances such control is a necessary protective device. For

vocate General of the Department of the Army has indicated that he did not concur in the *Lennox* decision, JAGT 1955/10001, Dec. 7, 1955, digested in The Judge Advocate General's School's Procurement Legal Service (DA Circular 715-50-25, ¶ 2, Jan. 11, 1956).

82. The reader might note that, insofar as it might apply to "may" clauses in contracts still under administration, DoD Directive 7840.1, April 22, 1954, 22 Fed. Reg. 837 (1957), provided that progress payments as defined therein were "necessary and useful" and "traditional and customary." In explaining DoD Directive 7840.1, DoD Directive 7800.4, pt. III A, Nov. 16, 1956, 22 Fed. Reg. 835 (1957) stated that DoD Directive 7840.1 "contemplates that provision for the customary progress payments described in its Part III, subject to the standards and limitations therein provided, will be made as a matter of course when requested by contractors who are known (from experience or adequate preaward investigation) to be reliable, competent, capable of satisfactory performance, in satisfactory financial condition, and to have an adequate accounting system and controls." See also DoD Directive 7840.1, pt. V supra.

83. The "may" clause contained language with respect to title-vesting similar to that discussed later in this article.

84. See note 82 supra.

instance, the contractor may be well down the road to default without the situation having reached the point where the facts indicate that the only course is to terminate his contract. In such case, it is quite clear that the Government would want to reserve the right to suspend further progress payments and not be shackled to the literal meaning of "shall".

Subparagraph (c) of the "Total Costs" clause provides that the contracting officer may "reduce or suspend progress payments, or liquidate them at a rate higher than the percentage stated . . . or both,"⁸⁵ whenever he makes certain findings "upon substantial evidence."⁸⁶ These findings which will justify reduction, suspension or acceleration are:⁸⁷ (a) that the contractor has failed to comply with any material requirement of this contract; (b) that the contractor has so failed to make progress, or is in such unsatisfactory financial condition as to endanger performance of the contract; (c) that the contractor has allocated inventory to the contract substantially exceeding reasonable requirements; (d) that the contractor is delinquent in payment of the costs of performance of the contract in the ordinary course of business; (e) that the contractor has so failed to make progress that the unliquidated progress payments exceed the fair value of the work accomplished on the undelivered portion of the contract; and (f) that the contractor is realizing less profit than the estimated profit used for establishing the liquidation percentage, if this percentage is less than that normally required.

1. Some Observations on "Substantial Evidence"

One clause in subparagraph (c) is worth more than passing notice. That is the clause, "whenever he finds upon substantial evidence." "Substantial evidence" is not an unfamiliar term in the law.⁸⁸ But it has special connotation in cases involving government contracts. Defense Department contracts featuring the "Progress Payments" clause will also contain the "Disputes" clause.⁸⁹ This clause in summary provides

85. 22 Fed. Reg. 827 (1957). The discussion is based on this clause. Subparagraph (c) of the "Direct Labor and Materials Costs" clause is only slightly different.

86. No comment is made on the effect of the contracting officer's failure to make findings and to reduce, suspend or accelerate, when justification therefor exists. Whether or not this constitutes a "waiver" of the Government's right to reduce, suspend or accelerate progress payments must be viewed in the light of subparagraph (i) of the clause, 22 Fed. Reg. 827 (1957). See Appendix. In connection with the subject of "waiver" under government contracts the reader is urged to read the splendid article, Cuneo, Waiver of the Due Date in Government Contract, 43 Va. L. Rev. 1 (1957), which contains comment that may by analogy apply to the progress payments situation.

87. Subparagraph (c), note 85 supra. Regulations explaining and implementing subparagraph (c) will be found in DCFR ¶ 522, 22 Fed. Reg. 832 (1957).

88. See 5 U.S.C.A. § 1009(e)(5) (1950), Consolidated Edison Co. v. NLRB, 305 U.S. 197, 229 (1938).

89. ASPR 7-103.12 (Sept. 7, 1956); CCH Gov't Contracts Rep. ¶ 29,363.

that the contracting officer shall decide disputes of fact between himself and the contractor arising under the contract. The contractor has a right of appeal to the secretary of the military department he has contracted with. Such appeals are heard by the Armed Services Board of Contract Appeals.⁹⁰ The contracting officer's decision is final, under the clause, on disputes of fact⁹¹ unless the decision is appealed by the contractor in timely fashion. If so appealed, the contracting officer's decision will be reviewed by the Board. The decision of the Board will, under the clause, be final unless it is found to have been fraudulent, capricious, arbitrary, so grossly erroneous as to imply bad faith, or not supported by substantial evidence. These criteria reflect the "Disputes" or "Wunderlich" Act of 1954.⁹² Neither the "Disputes" clause nor the "Disputes" Act make any express stipulation that the contracting officer's decision is to be "upon substantial evidence."

Subparagraph (c) however, so provides. The findings prescribed by subparagraph (c) relate chiefly to questions of fact. Therefore, a disagreement between the contractor and the contracting officer over whether one of the factors justifying reduction, suspension or acceleration exists can in most cases be resolved by the contracting officer's decision pursuant to the "Disputes" clause and such decision will be appealable. The interesting question is: upon such appeal what will be the scope of review by the Armed Services Board of Contract Appeals? Undoubtedly, if the Board finds that the contracting officer's decision is *not* supported by substantial evidence, then any action he has taken by way of reduction, suspension or acceleration must fall because it is not premised on a finding of the required sort. Will the Board limit itself to a considera-

90. The Board sits as the "duly authorized representative" of the secretary of the armed service which made the contract under which the appeal is prosecuted. See § 4 of the Board's Charter, ASPR App. A, pt. I, CCH Gov't Contracts Rep. ¶ 29,984. For discussion of the Board, see: Cuneo, *Armed Services Board of Contract Appeals: Tyrant or Impartial Tribunal?*, 39 A.B.A.J. 373 (1953); Joy, *The Disputes Clause in Government Contracts: A Survey of Court and Administrative Decisions*, 25 *Fordham L. Rev.* 11 (1956); Whelan, *A Government Contractor's Remedies: Claims and Counterclaims*, 42 *Va. L. Rev.* 301 (1956).

91. The clause so specifies. As to questions of law, 41 U.S.C.A. § 322 (Supp. 1956), provides: "No Government contract shall contain a provision making final on a question of law the decision of any administrative official, representative or board."

92. The language of § 1 of the Disputes Act, 41 U.S.C.A. § 321 (Supp. 1956) is: ". . . that any such decision shall be final and conclusive unless the same is fraudulent or capricious or arbitrary or so grossly erroneous as necessarily to imply bad faith, or is not supported by substantial evidence." "Substantial evidence" as thus used was a standard imported from 5 U.S.C.A. § 1009(e)(5) (1952) note 88 *supra*. H.R. Rep. No. 1380, 83d Cong., 2d Sess. 4 (1954). However, failure of the contractor to pursue his administrative remedy under the "Disputes" clause deprives him of his access to the courts. *Id.* at 6. And see *Atlantic Carriers, Inc. v. United States*, 131 F. Supp. 1 (S.D. N.Y. 1955).

tion of the evidence upon which the contracting officer based his finding or will it conduct a full-dress hearing in which testimony is taken and documents produced for the purpose of determining whether the findings of the contracting officer are justified by the facts?

This question must be viewed in the light of the evidence which a contracting officer can be expected to develop in support of his findings. Undoubtedly, the contracting officer will maintain surveillance⁹³ of the contractor's compliance with the requirements of the "Progress Payments" clause. He will have access to pertinent books and records of the contractor for this purpose.⁹⁴ In addition to his own investigations, he will be able to obtain the advice of the military audit agencies.⁹⁵ Thus, the contracting officer will have considerable opportunity to develop evidence. But, while his findings are required to be in writing,⁹⁶ there seems to be no express requirement that he furnish a copy of them to the contractor or that he conduct anything in the nature of a hearing in which the contractor can present witnesses, documents, etc.⁹⁷

93. DCFR ¶ 519, 22 Fed. Reg. 831 (1957); pt. V, DoD Directive 7840.1, April 22, 1954, 22 Fed. Reg. 837 (1957).

94. Subparagraph (g) of the "Total Costs" clause, 22 Fed. Reg. 828 (1957). If the contract is a negotiated one, the Comptroller General will also have access to the contractor's pertinent books and records. ASFR 7-104.15 (March 5, 1956), CCH Gov't Contracts Rep. ¶ 29,364, based on 10 U.S.C.A. § 2313(b) (Rev. 1956). The contractor is required to insert in his subcontracts a similar clause enabling the Comptroller General to have access to the subcontractor's books and records. *Ibid.* See also pt. I, para. 11, Exec. Order No. 10210, note 40 *supra*. In the event that the prime contractor's contract allows him reimbursement for progress payments he makes to subcontractors, he is required to insert in the subcontract progress payment clause language similar to that of subparagraph (g) of his own contract, i.e., language allowing the contracting officer access to the subcontractor's pertinent books and records. Obviously the prime contractor may require that he also be permitted such access. DCFR ¶ 512.2, 22 Fed. Reg. 829 (1957).

95. That is, the Army Audit Agency, the Navy Cost Inspection Service, and the Auditor General, the United States Air Force. DCFR ¶ 503, 22 Fed. Reg. 826 (1957). Policies and procedures of the military audit agencies are set forth in the Contract Audit Manual (Department of the Army Special Regulations 36-70-1, Department of the Navy NAVSANDA Publication No. 261, Department of the Air Force Manual 175-3) June, 1952, as changed.

96. DCFR ¶ 522, 22 Fed. Reg. 832 (1957).

97. It should be noted that DoD Directive 7840.1, pt. V, April 22, 1954, 22 Fed. Reg. 837 (1957) provides:

"In the process of reviewing individual progress payments already existing or hereafter established, action to reduce or slow down progress payments or to increase liquidation rates (unless justified on other grounds, such as overpayments or unsatisfactory performance) should be consistent with contract provisions, and never taken precipitately or arbitrarily. Any such reduction of progress payments on active contracts (other than normal liquidation pursuant to the contract) should be effected only after notice to and discussion with the contractor, and after full exploration of the contractor's financial condition, existing or available credit arrangements, projected cash requirements, effect of

And from the business standpoint the imposition of such a requirement on the contracting officer would be extremely burdensome. Nevertheless, the Contracting Officer must have "substantial evidence."

In the event that the contractor disagrees with the contracting officer's finding, and appeals the matter to the Armed Services Board of Contract Appeals, is there any reason to believe that the Board should or would confine its consideration of the case to the issue of whether or not the contracting officer's finding is based on substantial evidence as available to him or as stated in the written copy of his findings? It is unlikely that the contracting officer will develop a record susceptible of review for determination of whether there is, *within its bounds*, substantial evidence in support of it. Certainly, subparagraph (c) of the "Progress Payments" clause does not expressly limit the power of the Board under the "Disputes" clause to hear evidence and testimony submitted by both sides of the case. Nor should any such artificial limit be placed on the otherwise plenary review powers of the Board. No pertinent precedent has been found, however.

With respect to what he feels may be wrongful reduction, suspension or acceleration of the liquidation rate of progress payments, the contractor has a further remedy under the Tucker Act.⁹⁸ Somewhat unclear at the present time is the status to be accorded the Board's decision in a judicial proceeding under the Act. Both the Court of Claims and the district court (sitting as a court of claims) are courts of original jurisdiction before which there may be trial on the merits in cases involving claims on government contracts.⁹⁹ Both courts may award breach of contract damages against the Government,¹⁰⁰ and these damages would appear appropriate where the Government's action in reducing, suspending or accelerating is wrongful because not based on the requisite findings.

The issue is somewhat complicated, however, by the provisions of the "Disputes" Act. That Act provides that the decision of an appellate agency such as the Board of Contract Appeals ". . . shall be *final* and

progress payment reduction on the contractor's operations, and generally on the equities of the particular situation."

While contracting officers will undoubtedly act with fairness, pursuant to such directions as this one, it does not seem that they will develop the kind of record suitable for review for substantial evidence in support of their findings.

98. 28 U.S.C.A. § 1491(4) (Court of Claims), *id.* at § 1346(a)(2) (district courts) (1950), permitting such courts to render judgment on claims against the United States "founded upon any express or implied contract with the United States."

99. For a brief discussion, see Whelan, *A Government Contractor's Remedies: Claims and Counterclaims*, 42 Va. L. Rev. 301 (1956).

100. District court jurisdiction is limited to claims not exceeding \$10,000 in amount. 28 U.S.C.A. § 1346(a)(2) (1950). There is no monetary limitation on the jurisdiction of the Court of Claims in cases involving express and implied contracts.

conclusive unless the same is fraudulent or capricious or arbitrary or so grossly erroneous as necessarily to imply bad faith, or is not supported by *substantial evidence*.”¹⁰¹ Does this mean that the court is merely to review the whole record¹⁰² as developed by the Board and determine whether there is in that record substantial evidence to support its decision? This view of the statute was apparently taken by the court in *L. W. Foster Sportswear Co. v. United States*.¹⁰³ On the other hand, is the statute to be interpreted as permitting the court to consider all the evidence brought to its attention, including the record produced before the Board and the Board's decision, as well as such additional evidence as the contractor or the Government may offer to the court? If it does this, the court would, in effect, be reviewing the decision of the Board from the standpoint of whether all the evidence available sub-

101. See note 92 *supra*. (Emphasis added.)

102. The Board holds hearings, after appropriate notice, takes evidence (in general admissibility is determined under the generally accepted rules of evidence applied by United States courts in nonjury trials), examines witnesses under oath, records testimony and argument verbatim, and renders written decisions stating the pertinent facts in the case and its decision upon such facts. See the Board's Rules 16-29, ASPR App. A, pt. 2, CCH Gov't Contracts Rep. ¶ 10,721.01. Procedure before the Board, as revealed in these Rules does not seem entirely to justify the comments of the Court of Claims in *Volentine and Littleton v. United States*, — Ct. Cl. —, —, 145 F. Supp. 952, 954 (1956) when, in speaking about the Board's record, the court said in part:

“But the so-called ‘administrative record’ is in many cases a mythical entity. There is no statutory provision for these administrative decisions or for any procedure in making them. The head of the department may make the decision on appeal personally or may entrust anyone else to make it for him. Whoever makes it has no power to put witnesses under oath or to compel the attendance of witnesses or the production of documents. There may or may not be a transcript of the oral testimony. The deciding officer may, and even in the departments maintaining the most formal procedures, does, search out and consult other documents which, it occurs to him, would be enlightening, and without regard for the presence or absence of the claimant.

“If we were to attempt to make a decision on the basis of the ‘administrative record’ it would be a considerable task, in many cases, to gather together the pieces of that so-called record and get them all under our eyes at once. A helpful step in doing that would be to put the deciding officer on the stand and ask him what he knew when he made his decision. That step would, of course, be unthinkable.”

In some of these comments, the court may have been thinking of Board of Contract Appeals existing in other government departments and agencies (see CCH Gov't Contracts Rep. ¶ 10,725; 10,727; 10,735; 10,751; 10,761; 10,765; 10,771) but it was speaking in a case involving a decision of the Armed Services Board. Yet Congress apparently thought enough of the procedure before such Boards to provide that their decisions should be “final and conclusive.” 41 U.S.C.A. § 321 (Supp. 1956), note 92 *supra*.

103. 145 F. Supp. 148 (E.D. Pa. 1956). The court, in reviewing the record developed by the Board and finding the Board's decision supported by substantial evidence, seemed to feel no qualms about the acceptability of the record. See also 35 Comp. Gen. 512, 516 (1956).

stantially supported the Board's decision. That the court may apply the statute in this fashion is apparently supported by the decision of the Court of Claims in *Volentine and Littleton v. United States*.¹⁰⁴

B. Some Speculation About "Title-Vesting": Subparagraph (d) of the "Progress Payments" Clause

Discussion earlier in this article has indicated that long entrenched opinions of the Attorneys General and of government accounting officers demand that progress payments be made only when the United States receives an equivalent benefit therefor, that is, a title to, or a lien against, property acquired by the contractor for performance of the contract.¹⁰⁵

Subparagraph (d) of the new "Progress Payments" clause¹⁰⁰ complies with this mandate:

"When any progress payment is made under this contract, title to all parts; materials; inventories; work in process; special tooling as defined in the clause of this contract entitled 'Special Tooling'; nondurable (i.e., non capital) tools, jigs, dies, fixtures, molds, patterns, taps, gauges, test equipment, and other similar manufacturing aids not included within the definition of special tooling in such 'Special Tooling' clause; and drawings and technical data (to the extent delivery thereof to the Government is required by other provisions of this contract); *theretofore acquired or produced* by the Contractor *and allocated or properly chargeable* to this contract under sound and generally accepted accounting principles and practices shall forthwith vest in the Government; and *title to all like property thereafter acquired or produced* by the Contractor *and allocated or properly chargeable* to this contract as aforesaid shall *forthwith vest* in the Government *upon said acquisition, production or allocation.*" (Emphasis added.)¹⁰⁷

It seems sufficient to say that this clause pertains to a substantial part, if not nearly all, of the property the contractor might acquire for performance. It should be further observed that the clause pertains both to property of the type which will (or is intended to be) incorporated in the item being produced and also to property of the type that is not so to be incorporated, but which is useful in fabrication of the item, that is, such "manufacturing aids" as tools, jigs, dies, etc.

Aside from the character of the property to which subparagraph (d)

104. — Ct. Cl. —, 145 F. Supp. 952 (1956). Cf. *Williams v. United States*, 130 Ct. Cl. 435, 127 F. Supp. 617, cert. denied, 349 U.S. 938 (1955).

105. See p. 231 *supra*.

106. DCFR § 510.1(d), 22 Fed. Reg. 827 (1957), the "Total Costs" clause. Subparagraph (d) in the "Direct Labor and Materials Cost" clause is identical. *Id.* at 510.2(d), 22 Fed. Reg. at 828.

107. A "Special Tooling" clause is found at ASPR 13-504 (July 26, 1956), CCH Gov't Contracts Rep. ¶ 29,745; the "Default" clause is found at ASPR 7-103.11 (Dec. 23, 1955), CCH Gov't Contracts Rep. ¶ 29,363; the "Termination for Convenience of the Government" clause is found at ASPR 8-701 (Jan. 3, 1955), CCH Gov't Contracts Rep. ¶ 41,861.

relates, that provision prescribes the events or conditions¹⁰⁸ on which title to the described property is to vest in the Government. The provision also sets out some of the incidents of title. The remainder of this article consists of some speculations about the nature and incidents of this "title."

1. Pre- and Post-Payment Property

These events or conditions can be placed under two categories: (1) what may be called for brevity's sake pre-payment property, that is, property acquired or produced¹⁰⁹ before a progress payment is made; and (2) post-payment property, or property acquired or produced after a progress payment is made. The "title" difficulties with respect to both categories resemble each other in many cases but separate inspection will be helpful to analysis.

With respect to pre-payment property, title vests forthwith upon payment: (a) when the property is acquired and allocated; or (b) when it is acquired and properly chargeable; or (c) when produced and allocated; or (d) when produced and properly chargeable.

Where post-payment property is concerned, title vests forthwith upon acquisition, production *or* allocation: (a) when acquired and allocated; or (b) when produced and allocated; or (c) when acquired and properly chargeable; or (d) when produced and properly chargeable.

Speaking of the grammar and relation between the words of the subparagraph and not, for the moment, of the effectiveness of these words to vest title, the events or conditions on which title to post-payment

108. Clauses in use by the Army and Air Force in the past (and still, presumably, contained in many contracts under administration at the present time) set forth these "events" and "conditions" in a slightly different manner:

"(b) Upon the making of any progress payment under this contract, title to all parts, materials, inventories, work in process and nondurable tools theretofore acquired or produced by the Contractor for the performance of this contract, and properly chargeable thereto under sound accounting practice, shall forthwith vest in the Government; and title to all like property thereafter acquired or produced by the Contractor for the performance of this contract and properly chargeable thereto as aforesaid shall vest in the Government forthwith upon said acquisition or production. . . ."

Army Procurement Procedure 7-150.1 (b), (Dec. 20, 1956), CCH Gov't Contracts Rep. ¶ 19,690; Air Force Procurement Instruction 54-606(a)(c), CCH Gov't Contracts Rep. ¶ 26,714.6(a)(c). See note 79 supra.

109. That is, property "acquired" by the contractor from other contractors or suppliers, or property which he "produced" himself. "Acquired" property presumably does not include property furnished by the Government to the contractor, although in a loose sense the contractor acquires such property. The Government already has title to government-furnished property and the title-vesting provisions of subparagraph (d) are superfluous as to such property. See ASPR 13-101 (b), (April 30, 1956), CCH Gov't Contracts Rep. ¶ 29,702, for definition of "Government-furnished property."

property is said to vest must further be elaborated. Title vests forthwith upon acquisition or production or allocation.¹¹⁰ Test though it may the patience of the reader, it is wise to analyze further: (1) acquired (or produced) and allocated property might vest either on acquisition (or production) or allocation, but it seems reasonable to say that the latter event, that is, allocation, should be critical, else the word need not have been used; (2) acquired (or produced) and properly chargeable property may vest either on acquisition (or production) or allocation.

If the "or" in the phrase "acquisition, production, or allocation" were to be read as "and," a third event would be required in (2) in the last paragraph: that is, acquisition (or production) and proper chargeability and allocation would be required. It is not clear that this *is* what is meant, but something can be said for it. "Chargeable" considered alone seems to indicate an unfulfilled condition, whereas "allocated" seems to indicate something accomplished which will make the state of title more easily ascertainable. On some occasions, at least in statutory interpretation, taking "or" to mean "and" has been deemed proper.¹¹¹ On the other hand, nothing *in limine* inhibits the conclusion that title is meant to vest on acquisition or production, subject to something in the nature of defeasance if the property is not "properly chargeable"; allocation being an irrelevant event if proper chargeability exists.

While the words "acquired" or "produced" would seem to inspire no wish for combat even in a mind devoted to logomachy, the words "allocated" and "properly chargeable" offer a battle-ground for soldiers of the word. Apparently imported from the trade vocabulary of the ac-

110. Cf. the wording of APP 7-150.1, AFPI 54-606, quoted in note 108 *supra*. The writer does not know the reason for the use of "allocation" in subparagraph (d) in addition to "production" and "acquisition." It may be, however, that "allocation" was used to prescribe a test for title-vesting of items such as "common items," that is, items which may be used on both the government and commercial production of the contractor. Such items may be either acquired or produced by the contractor; but there would be some difficulty telling the title-vested items from others of the same appearance which are to be used on commercial production. One has only to think of standard nuts and bolts to see the difficulty. (For a definition of "common item" see ASPR 8-204 (Jan. 3, 1955), CCH Gov't Contracts Rep. § 41,714 pertinent to termination inventory.) Certainly some significant act by the contractor setting aside or segregating those of such common items intended to be devoted to the government contract would be useful in connection with title-vesting. Certainly, in the case of special parts, usable only in connection with the government contract, "allocation" does not seem a necessary event, except perhaps for cost-accounting purposes.

111. See 2 Sutherland, *Statutory Construction*, § 4923 (3d ed. 1943). Such construction is for use only when it best fulfils the intent of the legislature. If we substitute "administrative agency promulgating the 'Progress Payments' clause" for "legislature," we must still struggle with "best fulfillment."

countant and auditor¹¹² into the field of sales law, these words in subparagraph (d) seem to indicate that the contractor has set aside the property for the contract (allocated) and that the property is of the quality and quantity suitable to be set aside for the contract (properly chargeable). Probably no more sophisticated definition should be attempted. Most aptly the words relate to the validity or acceptability of an item of cost. In the law of sales they seem somewhat like a sheathed sword, its cutting edge concealed.¹¹³

If the contractor has acquired or produced property for the contract, has placed it in a portion of his factory used only for property intended for his government contract containing the "Progress Payments" clause, and he has further plainly stamped it "U.S.,"¹¹⁴ there is no doubt that it is allocated in the sense that it is appropriated or identified¹¹⁵ to the contract. Certainly, these events would be most helpful to a tax assessor or a trustee in bankruptcy seeking to reach a conclusion as to who is a title-holder and owner of the property.

It seems clear that the word "allocated" is not to be taken as meaning

112. The use of such words in government contract accounting is fairly standard. See, for examples of such usage, ASPR 15-201, 15-202 (Jan. 3, 1955), CCH Gov't Contracts Rep. ¶ 29,861-62. For an accountant's definition of these terms see Kohler, *Dictionary for Accountants* (1952).

113. In the sales of goods field, words like "appropriated," "identified" or "segregated" would seem ordinary usage. See notes 115, 150, 156 *infra*.

114. It is not intended, of course, to convey that only the events stated above are sufficient for "allocation." Perhaps segregation in separate storage facilities alone is enough. It is appropriate to observe that when a cost-reimbursement supply contractor acquires property for the performance of his contract and he is entitled to reimbursement for such acquisition, title to the property will vest in the Government pursuant to the terms of ASPR 13-503(b) (April 27, 1955), CCH Gov't Contracts Rep. ¶ 29,744, the so-called "Government Property" clause required to be inserted in cost-reimbursement supply contracts by the provisions of ASPR 7-203.21 (Sept. 7, 1956), CCH Gov't Contracts Rep. ¶ 29,371. Property so acquired by the contractor which thus becomes "Government Property" is subject to the elaborate and strict custodial, identification and record-keeping provisions of ASPR App. "B" ("Manual for Control of Government Property in Possession of Contractors"), CCH Gov't Contracts Rep. ¶ 29,751-75. ASPR 13-503(c), CCH Gov't Contracts Rep. ¶ 29,744, imposes compliance with ASPR App. "B" on the cost-reimbursement supply contractor. However, ASPR App. "B", ¶ 205.5 (April 30, 1956), CCH Gov't Contracts Rep. ¶ 29,760, provides: ". . . property to which the Government has acquired a lien or title solely as a result of partial, advance or progress payments shall not be subject to the provision of this manual." See also DCFR ¶ 524.2, 22 Fed. Reg. 833 (1957). Undoubtedly, if title-vested property under the "Progress Payments" clause were subject to the manual, problems of identification, and allocation would be more easily solved. For example, see ¶ 401 of the Manual, ASPR App. "B", CCH Gov't Contracts Rep. ¶ 29,771, and Army Procurement Procedure, 13-1711 (March 12, 1957), CCH Gov't Contracts Rep. ¶ 20,661 (containing detailed marking and identification instructions).

115. See Uniform Sales Act § 19, Rule 4 (1); Uniform Commercial Code §§ 2-401, 2-501 (see the 1956 Recommendations of the Editorial Board).

the same as "properly chargeable." Undoubtedly the Government does not want title and possession of property which is in excess of the quantitative needs of the contract (or property which varies from its qualitative requirements) but subparagraph (c)(iii) recognizes that there can be an allocation of property substantially in excess of the reasonable requirements of the contract, and this subparagraph can be read as meaning that this allocation is effective. The reason is not hard to find. If progress payments have been made upon the basis of the costs of the excessive property, the Government would probably want title to the property as security, at least until such time as any overpayments can be returned.¹¹⁶

It is undeniable that "properly chargeable" offers considerable difficulty in interpretation. Standing alone, it is potential in form and seems to point to some future occurrence. It apparently offers the Government a retrospective opportunity to release title or declare that it never vested. Thus, although it might be said that title to acquired and properly chargeable property vests on acquisition without any necessity for allocation, it is possible to conclude that the Government, by later determining that the property is not properly chargeable, can deny that title ever did vest.¹¹⁷ Assume that the contractor acquires 1,000 identical parts. All of these are capable of use on his government contract and on his other business from the qualitative standpoint. But the government contract calls for use of only 200 of the parts, that is, any 200. Aside from the rather unattractive conclusion that the Government and the contractor are tenants in common¹¹⁸ of the 1,000 parts, it seems extremely difficult to decide that the Government has title in view of the fact that one cannot point to specific property to which title attaches. On the other hand, if all 1,000 of the parts were usable on the government contract it seems less difficult to say that title has vested upon acquisition. One is left a little at a loss, however, in this case where all 1,000 parts are also usable for other business, unless the intent of the contractor to acquire these 1,000 items for the government contract controls. Perhaps,

116. Cf. DCFR ¶ 522.3, 22 Fed. Reg. 832 (1957).

117. In this connection, cf. the provisions of DCFR ¶ 524.5(b), 22 Fed. Reg. 834 (1957). Under this provision when the contract is completed (certain specific terminal events are prescribed) ". . . any excess property remaining is to be regarded as having not been allocated or properly chargeable to the contract under sound and generally accepted accounting principles and practices, and thus outside the scope of the progress payment clause which would have vested title in the Government." Insofar as this seems to permit a second guess as to whether title vested, it seems literally inconsistent with the provisions of subparagraph (d) pertaining to re-vesting of title after contract completion.

118. No intention to become tenants in common is expressed. Intention to this effect is critical. See Vold, *Sales* § 70 (1931); 1 Williston, *Sales* § 156 (rev. ed. 1948); Uniform Sales Act § 6. Cf. Navy Procurement Directive 7-102.1 (July 20, 1956) (not in CCH).

if the property is usable on the government contract alone, there is no difficulty, but subparagraph (d) does not indicate that "properly chargeable" is confined to this type of property. It is precisely in this area that one wishes that "or" in the phrase "acquired, produced, or allocated" could be read as "and." Then, it would seem, some sort of appropriation or identification to the contract should be made.

2. Incidents of Title

a) *Current Production Scrap*

Insofar as work on property subject to subparagraph (d) generates current production scrap, the contractor is authorized to sell such property without securing the contracting officer's permission.¹¹⁹ In the event the contractor does sell the scrap, then the proceeds of the sale "shall be credited against the costs of contract performance." Normally, if a fixed-price contractor (without a "Progress Payments" clause in his contract) generates such scrap, any profit he makes from the sale is his own. In the case of the contractor whose contract does contain the "Progress Payments" clause, the property which yields the scrap may be title-vested property under the clause. Does the phrase "credited against the costs of performance" mean that the contractor must return the proceeds of the sale to the Government in the form of a reduction of the total contract price? Or does it mean that the proceeds of sale should be credited against the costs upon which progress payments are based so that a reduction in progress payments must be made? Either conclusion seems possible, but it is suggested that the latter is the more reasonable in the light of all the circumstances. Presumably the Government does not intend to deprive the contractor of a fund to which he would be entitled in the absence of a "Progress Payments" clause. In any event, however, it would seem that the contractor can act in such a way as to insure retention of the proceeds of scrap sales. The penultimate sentence of subparagraph (d) provides that title to all "left-overs" after contract completion will re-vest in the contractor. It is hard to see how title to scrap would not re-vest. If the contractor sells current production scrap after such re-vesting, he is certainly only selling his own property and is, of course, entitled to the proceeds.

b) *Acquisition and Disposition*

Title-vested property other than current production scrap can also be taken out of contract inventory by the contractor. Subparagraph (d) provides that the contractor may "acquire" or "dispose of" such property with the permission of the contracting officer. Presumably this

119. See Appendix for this provision.

means that the contractor may acquire the property for himself or dispose of it to third persons.¹²⁰ Neither the subparagraph nor the "Defense Contract Financing Regulations" specify what is to be done with the proceeds of any disposition.¹²¹ The clause¹²² does provide that the costs of property so acquired or disposed of are to be ". . . eliminated from the costs of contract performance, and the contractor shall be required to repay to the Government (by cash or credit memorandum) an amount equal to the unliquidated progress payments allocable to the property so transferred" It should be noted here that if this property is actually the Government's, the method of treating the proceeds of disposition does not seem consistent with the normal rights of a title-holder or owner. One would think that the Government would want the proceeds.¹²³ On the other hand, the requirement that the contracting officer give his approval of any acquisition or disposal seems consonant with the handling, in other circumstances, of what is known as "contractor inventory."¹²⁴

120. This would seem to be the normal import of these terms. "Acquire" is used in a similar sense with reference to termination inventory, in ASPR 8-608.1 (March 5, 1956), CCH Gov't Contracts Rep. ¶ 41,843.1.

121. Note that when the Government sells its own property, the proceeds of the sale generally go into the Treasury as miscellaneous receipts. 40 U.S.C.A. § 485 (Supp. 1956). However, "where any contract entered into by an executive agency or any subcontract under such contract authorizes the proceeds of any sale of property in the custody of the contractor or subcontractor to be credited to the price or cost of the work covered by such contract or subcontract, the proceeds of any such sale shall be credited in accordance with the contract or subcontract." 40 U.S.C.A. § 485(e) (Supp. 1956). It seems reasonable to say, therefore, that when government property is sold, the Government is to get the proceeds either by deposit in the Treasury or by credit of the proceeds against the contract price. The handling of the proceeds of disposals of title-vested property under the "Progress Payments" clause do not seem consistent with the provisions of this statute. One tends, because of this, to question whether the Government's title under the "Progress Payments" clause is intended to be the title of an owner. It might be commented that if the phrase "credited against the costs of performance," used in subparagraph (d) with respect to sales of current production scrap, were interpreted to mean the same as "credited to the price or cost of the work," then the scrap sales provision would be consistent with the requirements for handling the proceeds of sales under § 204, supra. Cf. the discussion in the text, p. 253 supra.

122. See also DCFR ¶ 524.5, 22 Fed. Reg. 833-34 (1957).

123. See note 121 supra.

124. "Contractor inventory" is defined in 40 U.S.C.A. § 472(k) (1952):

"The term 'contractor inventory' means (1) any property acquired by and in the possession of a contractor or subcontractor under a contract pursuant to the terms of which title is vested in the Government, and in excess of the amounts needed to complete full performance under the entire contract; and (2) any property which the Government is obligated to take over under any type of contract as a result either of any changes in the specifications or plans thereunder or of the termination of such contract (or subcontract

c) Title "Re-vesting"

Subparagraph (d) also contains a provision, mentioned earlier, to the effect that title to contract "left-overs" re-vests in the contractor. This provision is as follows:

"Upon completion of performance of all the obligations of the Contractor under this contract, including liquidation of all progress payments hereunder, title to all property (or the proceeds thereof) which had not been delivered to and accepted by the Government under this contract . . . and to which title has vested in the Government under this clause shall vest in the Contractor."¹²⁵

In sum then, "left-overs" are to belong to the contractor. Certainly it seems clear that Government has entered into the contract for the purpose of purchasing the desired items and not property such as "left-

thereunder), prior to completion of the work, for the convenience or at the option of the Government."

Title-vested property under the "Progress Payments" clause might well qualify as "contractor inventory" under the first part of the definition, *supra*, except for the technical objection that once title-vested property under the "Progress Payments" clause is found to be in excess of the needs of the contract (i.e., it is not delivered to or accepted by the Government after completion of performance), then title re-vests in the contractor (Penultimate sentence of subparagraph (d); see Appendix, *infra*). "Contractor inventory" does not seem to cover that situation at all. Under 40 U.S.C. § 484(f) (1952):

"Subject to regulations of the Administrator [of General Services], any executive agency may authorize any contractor with such agency or subcontractor thereunder to retain or dispose of any contractor inventory."

Putting the technical objection aside, if title-vested property is "contractor inventory," the clauses and regulations in the Defense Contract Financing Regulations permitting the contractor to acquire or dispose of title-vested property "with the consent of the Contracting Officer and on terms approved by him" seem to be adequate implementation of § 484(f) *supra*. Further, the Administrator of General Services has approved "Progress Payments" clauses containing the same language with respect to acquisition and disposal as does the "Progress Payments" clause under discussion. See subparagraph (d), Exhibit "D", Personal Property Management Regulation No. 33, Dec. 31, 1956, CCH Gov't Contracts Rep. ¶ 24,879. (This regulation was developed cooperatively with the Department of Defense.) On the other hand, taking the technical objection above as important, no reason is perceived why the contractor needs anyone's authority to dispose of title re-vested property. In one connection, however, treatment of title-vested property as "contractor inventory" may be useful: that is, when the contractor desires, during the course of contract performance, to acquire or dispose of title-vested property, he may do so with the contracting officer's approval and there should be no objection to this disposal of property in which the Government has a "title" interest. This is subject to the proviso that such property is "in excess of the amounts needed to complete full performance under the entire contract." The troubled point remains, as intimated in note 121 *supra*, that if the Government has title to and owns the property, proceeds of acquisition or disposal should be placed in the Treasury, in view of the fact the contract does not provide for them to be credited to the cost of performance.

125. To place this language in context, see Appendix, *infra*.

overs."¹²⁶ This provision does not seem perfectly consistent with the idea that the Government has acquired the title of an owner to the types of property described in subparagraph (d). It might be recalled that among the items to which title vests are things such as dies, gauges, jigs and other such "manufacturing aids." Presumably, many of these items will be among the "left-overs." Also, any type of property to which the Government has taken title may be numbered among "left-overs," insofar as it is not delivered to and accepted by the Government. One is prone to conclude that the Government's title is a tentative one, something more nearly a security device than the title of an owner.¹²⁷

d) Special Rules

The second sentence of subparagraph (d) provides:

"Notwithstanding that title to property is in the Government through the operation of this clause, the handling and disposition of such property shall be determined by the applicable provisions of this contract such as: the Default clause and paragraph (h) of this clause; Termination for Convenience of the Government clause; and the Special Tooling clause."¹²⁸

The intent of this provision is that, despite title-vesting, the handling of title-vested property will, in certain events, be determined according to other provisions of the contract. Particularly interesting is the handling to be accorded to property when either the "Default" clause¹²⁹ or the "Termination for Convenience of the Government" clause¹³⁰ is applicable. If the contract is terminated pursuant to the "Default" clause, the Government may elect to take title to and delivery of certain items called collectively "manufacturing materials" and will pay the contractor for items so delivered.¹³¹ Pursuant to subparagraph (h) of

126. The fact should never be lost sight of that the "Progress Payments" clause of which we are speaking is used principally in fixed-price supply contracts. Under such contracts, the Government is buyer and the contractor is seller of an end item, whether a tank or gun or an airplane or some item of electronic equipment. The Government is not contracting for the purchase of title-vested property, as such, but only for the acquisition of such part of that property as is incorporated in the end items.

127. See DCFR § 524.5(b), 22 Fed. Reg. 834 (1957), quoted in note 117 *supra*, for an interesting sidelight. One point in this subparagraph of the Regulations seems to be that title to property excess to the contract never vested in the Government. This seems inconsistent with the words of the title re-vesting provision.

128. The text of subparagraph (h) of the "Progress Payments" clause, referred to in subparagraph (d), note 124 *supra*, will be found in the Appendix, *infra*. The provisions of a "Special Tooling" clause such as referred to in subparagraph (d) are found in ASPR 13-504 (July 20, 1956), CCH Gov't Contracts Rep. ¶ 29,745.

129. ASPR 7-103.11 (Dec. 23, 1955), CCH Gov't Contracts Rep. ¶ 29,363.

130. ASPR 8-701 (Jan. 3, 1955), CCH Gov't Contracts Rep. ¶ 41,861.

131. This is pursuant to subparagraph (d) of the "Default" clause which provides: "If this contract is terminated as provided in paragraph (a) of this clause, the Govern-

the "Progress Payments" clause, title to the portion of the title-vested property which the Government does not elect to take under the "Default" provision will re-vest in the contractor when he liquidates outstanding progress payments. It is interesting to note that "manufacturing materials" under the "Default" clause and title-vested property under "Progress Payments" are not identical. "Manufacturing Materials," for example, include only "partially completed supplies and materials" whereas subparagraph (d) vests title to all "materials." It would seem that, in the event of termination for default, the Government might not be able to demand delivery of all title-vested property. A true owner, one feels, should be able to make such demand.

If the contract is terminated for the convenience of the Government pursuant to the clause so permitting, the handling of those portions of title-vested property which are part of "termination inventory"¹³² are to be handled under the specific provisions of that clause.¹³³ Although it may seem an insubstantial point, the "Termination for Convenience"

ment, . . . , may require the Contractor to transfer title and deliver to the Government, in the manner and to the extent directed by the Contracting Officer, (i) any completed supplies, and (ii) such partially completed supplies and materials, parts, tools, dies, jigs, fixtures, plans, drawings, information and contract rights (hereinafter called 'manufacturing materials') as the Contractor has specifically produced or specifically acquired for the performance of such part of this contract as has been terminated The Government shall pay to the Contractor the contract price for completed supplies delivered to and accepted by the Government, and the amount agreed upon by the Contractor and the Contracting Officer for manufacturing materials delivered to and accepted by the Government and for the protection and preservation of property. Failure to agree shall be a dispute concerning a question of fact within the meaning of the clause of this contract entitled 'Disputes.'

132. "Termination inventory" (which appears to fall within the meaning of "contractor inventory," note 124 supra, is defined in ASPR 8-231 (Nov. 8, 1955), CCH Gov't Contracts Rep. ¶ 41,741.

133. ASPR 8-701(b)(6), CCH Gov't Contracts Rep. ¶ 41,861 provides that the contractor shall:

". . . transfer title and deliver to the Government, in the manner, at the times, and to the extent, if any, directed by the Contracting Officer, (i) the fabricated or unfabricated parts, work in process, completed work, supplies, and other material produced as a part of, or acquired in connection with the performance of, the work terminated by the Notice of Termination, and (ii) the completed or partially completed plans, drawings, information, and other property which, if the contract had been completed, would have been required to be furnished to the Government"

Regulations dealing with the handling and disposition of such property are found in ASPR § VIII, pt. 6, CCH Gov't Contracts Rep. ¶ 41,835-51. However, the reader should note the provisions of DCFR ¶ 524.4, 22 Fed. Reg. 833 (1957) which emphasizes that, even though termination inventory is to be handled under the "Termination for Convenience of the Government" clause, title to such property is to be regarded as having vested under the "Progress Payments" clause.

clause contemplates that the contractor tender title¹³⁴ to the Government of items of termination inventory which will be included in his settlement claim. Significantly, the contractor is to be encouraged¹³⁵ to retain, sell, or purchase for himself items of termination inventory "subject to the Government's right under the Standard Termination Clause to acquire title to, and to require delivery to it of, any items of termination inventory."

The provisions of subparagraph (e)¹³⁶ should also be noted. Under this subparagraph, risk of loss, theft, destruction or damage to title-vested property is the contractor's and not the Government's. In the event of such loss, theft, destruction or damage (before delivery to and acceptance by the Government) the matter is to be handled in a way similar to that employed in the case of title-vested property "acquired" or "disposed of" under subparagraph (d): that is, the contractor is required to repay to the Government an amount equal to the unliquidated progress payments allocable to the property. If the contractor replaces such property out of his own pocket or out of the proceeds of insurance policies maintained by him, such payment is undoubtedly not necessary. Assumption of this sort of risk by a person in possession of title-vested property is not inconsistent with the Government's title. But when the allocation of risk is considered in connection with the other incidents of title discussed in the preceding paragraphs one wonders whether the risk is not being allocated to the real owner.

One or two things remain to be mentioned. The clause does not specify the result when the contractor has acquired property for performance of the contract and his vendor retains title. Presumably, in such case, the vendor's title continues in existence, although otherwise the property might be regarded as "title-vested."¹³⁷ The clause does not subject title-

134. See note 133 *supra*, for the provisions of DCFR ¶ 524.4.

135. See ASPR 8-601.1 (Nov. 8, 1955), CCH Gov't Contracts Rep. ¶ 41,836.1.

136. Compare this provision with the provisions in ASPR 13-503 (April 27, 1955), CCH Gov't Contracts Rep. ¶ 29,744. This clause, the "Government Property" clause, for cost-reimbursement supply contracts provides that title to property acquired by the contractor for which he is entitled to reimbursement as a contract cost shall vest in the Government. In this it parallels subparagraph (d) of the "Progress Payments" clause. But the risk of loss, etc., is allocated differently in the two clauses. Under ASPR 13-503(f), *supra*, in general the contractor is not to bear the risk of loss or damage to government property, subject to certain stated exceptions. See also note 114 *supra*.

137. There may also be sales in which the seller to the contractor retains some security interests. Subparagraph (d) contains no express provision covering such cases; perhaps this is an indication of the frequency with which they can be expected to occur. Of interest in this connection are the provisions of DCFR ¶ 524, 22 Fed. Reg. 833 (1957) relating to incumbrances on title-vested property:

"Since the clauses in 510 give the Government title to all of the materials, work in process,

vested property to the strict and costly regulations pertaining to the custody of government property.¹³⁸ Probably, this exemption is granted, not because the Government intends to waive title, but because imposition of the extra costs of compliance on a fixed-price contractor without increase of the contract price would be an undue imposition.

Although there are several decisions upholding the effectiveness of title-vesting provisions in progress payment or similar clauses,¹³⁹ no decision has as yet interpreted the clause which has been discussed. There are, however, some decisions under a somewhat similar clause.¹⁴⁰ In one of these, *American Motors Corp. v. Kenosha*,¹⁴¹ the Wisconsin

and finished goods under contracts after the making of progress payments thereon, care should be taken to assure, to the extent reasonably necessary, that the title to the Government will be free of all incumbrances. The procedure in this respect will necessarily vary with the particular circumstances of individual cases. Ordinarily, in the absence of reason to believe that the Government title may be subject to incumbrance, the contractor's certificate will be relied on. If any arrangements or conditions are found that would impair the contractor's right of disposition of the property affected by progress payments, appropriate arrangements should be made to establish and protect the Government title. The existence of any such incumbrance is a violation of the contractor's obligations under the contract." Certainly there is no express promise on the contractor's part in subparagraph (d) to make title available without incumbrance. It may not be unreasonable, however, to imply such a promise; but, in any event, it would seem that the most effective way of establishing that acquisition of encumbered property is a violation of the contractor's obligations would be by inserting appropriate language in subparagraph (d).

138. See notes 114, 136 supra.

139. See, e.g.: *United States v. Ansonia Brass & Copper Co.*, 218 U.S. 452, 466 (1910) (the contract clause provided that parts paid for by the progress payments would "become thereby the sole property of the United States"; contract called for building a naval dredge); *Craig v. Ingalls Shipbuilding Corp.*, 192 Miss. 254, 5 So. 2d 676 (1942) (cost-plus contract for construction of vessels; the clause provided that title to equipment supplies and all other property as well as title to the vessel itself, on account of which payments were made, vested immediately in the Government); *Douglas Aircraft Co. v. Byram*, 57 Cal. App. 2d 311, 313, 134 P.2d 15, 16 (1943) ("The title to all property upon which any partial [i.e., progress] payment is made prior to the completion of this contract, shall vest in the Government in its then condition forthwith upon the making of any such partial payment or payments."); *In re Read-York, Inc.*, 152 F.2d 313 (7th Cir. 1945) (same clause as in the *Douglas Aircraft Co.* case). See also *Westinghouse Elec. Corp. v. State Tax Comm'n*, 206 Md. 392, 111 A.2d 661 (1955).

140. The clauses are the same or substantially the same, as the one found in Army Procurement Procedure 7-150.1 and Air Force Procurement Instruction 54-606, note 103 supra. These clauses provide for title-vesting of both pre-payment and post-payment property, re-vesting of left-overs after completion of the contract, imposition of risk of loss on the contractor; disposition of current production scrap and acquisition or disposition of other title vested property by the contractor. There are some dissimilarities, notably with respect to the proceeds of a sale or disposition; such proceeds were apparently to be credited against unliquidated progress payment and, if any balance were left over, this was to be paid or credited to the Government.

141. 274 Wis. 315, 80 N.W.2d 363 (1957).

Supreme Court has reached the conclusion that the Government's title is not such as to preclude the imposition of a personal property tax on the contractor as the owner of title-vested property. In *Detroit v. Murray Corp.*,¹⁴² the Court of Appeals for the Sixth Circuit has reached the opposite conclusion under the same clause. In *United States v. Lennox Metal Mfg. Co.*,¹⁴³ the Court of Appeals for the Second Circuit apparently believed that the title-vesting provisions of this same clause created an "equitable lien." The recent orotund pronouncements of *In the Matter of American Boiler Works, Inc.*,¹⁴⁴ do not appear to contribute much to an incisive understanding of subparagraph (d) of the "Progress Payments" clause. *Detroit v. Murray Corp.* is before the Supreme Court.¹⁴⁵ Without doubt, the decision of the Court in this case involving a clause similar to subparagraph (d) will dispose of many vexing title difficulties.

Meanwhile it may be neither presumptuous nor amiss to notice some of the principles that may furnish assistance in interpreting the title-vesting provision. True it is that "the validity and construction of contracts through which the United States is exercising its constitutional functions, their consequences on the rights and obligations of the parties, the titles or liens which they create or permit, all present questions of federal law not controlled by the law of any state."¹⁴⁶ But in the absence of controlling federal law, decisional or otherwise, the courts may construe government contracts according to the law which governs the

142. 234 F.2d 380 (6th Cir. 1956).

143. 225 F.2d 302, 317 (2d Cir. 1955).

144. 220 F.2d 319 (3d Cir. 1955). The clause in this case is different from the others that have been discussed. Apparently, the clause is the same as art. 3 of the "General Provisions" of the Navy Department Vessel Form Contract. This article provides for both lien and title; with respect to title, the clause does not make vesting contingent on progress payments but rather upon delivery to the plant of the contractor or other place of storage selected by him, whichever of said events shall first occur. Title may also vest, if the contract administrator elects, on delivery to a carrier for shipment to the contractor. Said Judge Goodrich:

"The title, both to the vessels and to materials, vested in the Government with no ifs, ands or buts.

". . . .

". . . . Regardless of whether the reason back of the provision is beneficent or harsh, however, here we have the sovereign making a contract. In the absence of constitutional inhibitions the sovereign can make such contract as it pleases and no one can object."

Id. at 321.

145. Cert. granted, 352 U.S. 963 (1957).

146. *United States v. County of Allegheny*, 322 U.S. 174, 183 (1944). The same decision indicates that state recordation acts do not apply to titles vested in the Government under its contracts; to the same effect on this point is *In re Read-York, Inc.*, 152 F.2d 313 (7th Cir. 1945).

contracts of private parties,¹⁴⁷ not regarding the law of any state as determinative. In doing so, the courts need not consider themselves precluded from inquiry into the real nature of the "title" said to be vested in the Government.¹⁴⁸

Generally, under the law applicable to private parties, a seller who contracts to sell goods which he has not as yet acquired cannot pass title to the goods merely by his contract to do so.¹⁴⁹ His contract is, of course, as enforceable as any other in case of breach.¹⁵⁰ Title to the goods, however, does not pass even on acquisition unless there is some act of appropriation or identification of the goods to the contract.¹⁵¹ Certain exceptions, not applicable here, are recognized, as in the case of equitable mortgages,¹⁵² estoppel of the seller,¹⁵³ and "potential possession."¹⁵⁴ Insofar as an allocation of either "pre-payment" or "post-payment" property is made under subparagraph (d), it might well qualify as an appropriation or identification.¹⁵⁵ It is somewhat hard to see how these prin-

147. *S.R.A., Inc. v. Minnesota*, 327 U.S. 553, 564 (1946).

148. *Offutt Housing Co. v. County of Sarpy*, 351 U.S. 253, 261 (1956).

149. Uniform Sales Act § 5; 1 Williston, Sales § 130 (rev. ed. 1948); Vold, Sales 103-04 (1931). See Uniform Commercial Code § 2-401.

150. 1 Williston, Sales § 137 (rev. ed. 1948); Vold, Sales 103-04 (1931); Uniform Sales Act § 5(3).

151. "Appropriation" seems to be the usual terminology; See 2 Williston, Sales §§ 273a, 274 (rev. ed. 1948); Vold, Sales 103-04 (1931); Uniform Sales Act § 19, Rule 4(1). "Identification" is the term chosen by the Uniform Commercial Code §§ 2-401, 2-501. The language of the text is somewhat loose in bespeaking "title"; under the Uniform Sales Act, supra, "property" passes on appropriation if that is what the parties intend; under the Uniform Commercial Code, supra, a "special property interest" is created on identification. Unless some sort of security title is all that is involved, it would seem that the title of an owner could not pass prior to passing of "property" or creation of the "special property interest."

152. Roughly speaking, if the parties make an agreement to mortgage personal property subsequently to be acquired, acquisition gives the mortgagee a lien on the property: see 1 Williston, Sales §§ 133-44 (rev. ed. 1948); Vold, Sales 114 (1931). The doctrine does not appear to be applicable to contracts for sale of non-unique chattels, the basis for it being that equity will grant specific performance of an agreement for security. Unless the interest of the Government under subsection (d) of the "Progress Payments" clause is merely that of a mortgagee, the doctrine would appear to be inapplicable here.

153. Thus, "if a seller purports to make a present sale of goods which he does not own, and the buyer is ignorant of the seller's lack of title" but relies thereon, title to the goods is said to pass by estoppel when the seller acquires title. 1 Williston, Sales § 131 (rev. ed. 1948). This principle does not appear to apply to cases arising under subparagraph (d).

154. This rule is chiefly for application in cases involving contracts for the sale of crops to be grown, the sale of unborn young of animals, or wool. 1 Williston, Sales §§ 133-36; Vold, Sales 104-09 (1931). It does not apply to contracts for the future acquisition or manufacture of goods. *Ibid.* See Uniform Commercial Code § 2-501.

155. That is, if it amounts to a definite earmarking of the property to the contract. See note 150 supra. Probably, the question of whether or not an act of allocation also con-

ciples would justify recognition of title to "properly chargeable" property, not yet "allocated."

In the event a seller agrees to sell a part of a mass of goods in his possession (which might be the case where a government contractor had a stock of common items¹⁵⁶ some of which were "properly chargeable"), the rule applicable to contracts between private parties seems to be that title to a specific part of the mass will be transferred to the buyer only if there is some act of selection or appropriation¹⁵⁷ by the seller. The parties may intend to become tenants in common of the mass, in which case their intention is to be given effect if clearly demonstrated.¹⁵⁸ Such tenancy does not appear to have been bargained for in subparagraph (d).

There is also some basis, though this has not found wide acceptance in the United States, for application of the doctrine of accession in contracts for the sales of goods.¹⁵⁹ Thus, if the seller adds parts to, or improves, the buyer's own goods, the result may be that title to the additions or improvements passes to the buyer. In a government supply contract, this would be most nearly applicable in cases where the Government delivers its own property to the contractor (for example, where it furnishes cloth to a manufacturer of uniforms). Where the Government's title to the property to which the accession is made depends solely on subparagraph (d), the validity of that title must be determined before the doctrine of accession can be properly applied.

In addition to the foregoing, one ought also, perhaps, consider the fact that the Government is not paying full value for title-vested property¹⁶⁰

stituted an act of "appropriation" or "identification" would have to be determined on a case by case basis. Insofar as Uniform Sales Act § 19, Rule 4(1) requires "assent" to an act of appropriation, it would seem that any act of allocation by the contractor has the assent in advance of the United States through the medium of the "Progress Payments" clause.

156. See note 110 *supra*.

157. See 1 Williston, Sales § 158 (rev. ed. 1948); Vold, Sales 191-223 (1931); and see Uniform Sales Act § 17.

158. See 1 Williston, Sales § 156 (rev. ed. 1948), Vold, Sales 189-91 (1931); Uniform Sales Act § 6. As a point of information, note that this rule is recognized in at least one area of government contracting. The Navy Department "Progress Payments and Liens" clause, Navy Procurement Directive 7-102.1 (July 20, 1956) (not in CCH) provides in part:

"b. . . . If such property is not identified by marking or segregation, the Government shall be deemed to have a lien upon a proportionate part of any mass of property with which such property is commingled. . . ."

159. See Vold, Sales 198-200 (1931), 2 Williston, Sales § 276 (rev. ed. 1948). Here again, the intent of the parties seems critical, that is, they must intend that accession to the buyer's goods results in passage of title to the buyer of the things added.

160. In this connection, see Walsh, Mortgages § 7, particularly pp. 38-41 (1934). And see Pasley, *supra* note 81, at 235-236.

and the fact that it is not the Government's primary objective under its contract to secure such title but rather to secure the delivery of acceptable finished products.

The analysis of subparagraph (d) set forth at such great length in this part of the article seems to be weighted on the side of a declaration that the Government acquired no title (except perhaps some sort of security interest) to property subject to the "Progress Payment" clause. To this conclusion the author inclines.

But all the preceding analysis of subparagraph (d) is subject to some over-all criticism and the points behind this criticism may well lead courts to conclude that title has, indeed, really vested in the Government as owner. First, one of the literal results of the analysis might be that the Government might well acquire a sort of "fragmentary" title, that is, title to some items (for example, "allocated" items) and not to others, and that this is undesirable. (This is subject, it seems, to the counter that it may be equally as good under such circumstances to decide that no title at all has vested.) Secondly, such a clause as the "Progress Payments" clause bears an intimate relation to national interests and policy; perhaps, then, it is better to let the sovereign have its way¹⁶¹ than to place obstacles in the path of removal of property from strike bound plants or to deny the Government its "equivalent benefit" when it has to seek under an antique statute¹⁶² to meet modern business needs.

Indeed it would be a radical and ameliorative step if Congress should clearly and expressly authorize the title-vesting provisions of the "Progress Payments" clause. The author recommends that this be done.

APPENDIX

510.1 *Total Costs Clause.*

PROGRESS PAYMENTS

Progress payments shall be made to the Contractor as work progresses, from time to time upon request, in amounts approved by the Contracting Officer upon the following terms and conditions:

(a) *Computation of Amounts.*

(1) Unless a smaller amount is requested, each progress payment shall be (i) 75 percent of the amount of the Contractor's total costs incurred under this contract plus (ii) to the extent if any provided in the Schedule, the amount of the progress payments made by the Contractor to its subcontractors and remaining unliquidated; all less the sum of previous progress payments.

(2) The Contractor's total costs shall be reasonable, allocable to this contract, and consistent with sound and generally accepted accounting principles and practices. However, such costs shall not include (i) any costs incurred by subcontractors or suppliers, or (ii) any payments or amounts payable to subcontractors or suppliers, except for completed work (including partial deliveries) to which the contractor has acquired title

161. In the Matter of American Boiler Works, 220 F.2d 319, 321 (3d Cir. 1955).

162. Rev. Stat. § 3648, as amended, 31 U.S.C.A. § 529 (1952).

and except for amounts paid or payable under cost-reimbursement or time and material subcontracts for work to which the Contractor has acquired title, or (iii) costs ordinarily capitalized and subject to depreciation or amortization except for the properly depreciated or amortized portion of such costs.

(3) The amount of unliquidated progress payments shall not exceed the lesser of (i) 75 percent of the costs mentioned in (a)(1)(i), above, plus any unliquidated progress payments mentioned in item (a)(1)(ii) above, both of which are applicable only to the supplies and services not yet delivered and invoiced to and accepted by the Government, or, (ii) 75 percent of the total contract price of supplies and services not yet delivered and invoiced to and accepted by the Government, less unliquidated advance payments.

(4) The aggregate amount of progress payments made shall not exceed 75 percent of the total contract price.

(5) If at any time a progress payment or the unliquidated progress payments exceed the amount permitted by this paragraph (a), the Contractor shall pay the amount of such excess to the Government upon demand.

(b) *Liquidation.* Except as provided in the clause entitled "Termination For Convenience of the Government," all progress payments shall be liquidated by deducting from any payment under this contract, other than advance or progress, the amount of unliquidated progress payments, or 75 percent of the gross amount invoiced, whichever is less. Repayment to the Government required by a retroactive price reduction will be made after recalculating liquidations and payments on past invoices at the reduced prices and adjusting the unliquidated progress payments accordingly.

(c) *Reduction or Suspension.* The Contracting Officer may reduce or suspend progress payments, or liquidate them at a rate higher than the percentage stated in (b) above, or both, whenever he finds upon substantial evidence that the Contractor (i) has failed to comply with any material requirement of this contract, (ii) has so failed to make progress, or is in such unsatisfactory financial condition, as to endanger performance of this contract, (iii) has allocated inventory to this contract substantially exceeding reasonable requirements, (iv) is delinquent in payment of the costs of performance of this contract in the ordinary course of business, (v) has so failed to make progress that the unliquidated progress payments exceed the fair value of the work accomplished on the undelivered portion of this contract, or (vi) is realizing less profit than the estimated profit used for establishing a liquidation percentage in paragraph (b), if that liquidation percentage is less than the percentage stated in paragraph (a)(1).

(d) *Title.* When any progress payment is made under this contract, title to all parts; materials; inventories; work in process; special tooling as defined in the clause of this contract entitled "Special Tooling"; nondurable (i.e., non capital) tools, jigs, dies, fixtures, molds, patterns, taps, gauges, test equipment, and other similar manufacturing aids not included within the definition of special tooling in such "Special Tooling" clause; and drawings and technical data (to the extent delivery thereof to the Government is required by other provisions of this contract); theretofore acquired or produced by the Contractor and allocated or properly chargeable to this contract under sound and generally accepted accounting principles and practices shall forthwith vest in the Government; and title to all like property thereafter acquired or produced by the Contractor and allocated or properly chargeable to this contract as aforesaid shall forthwith vest in the Government upon said acquisition, production or allocation. Notwithstanding that title to property is in the Government through the operation of this clause, the handling and disposition of such property shall be determined by the applicable provisions of this contract such as: the Default clause and paragraph (h) of this clause; Termination for Convenience of the

Government clause; and the Special Tooling clause. Current production scrap may be sold by the Contractor without approval of the Contracting Officer and the proceeds shall be credited against the costs of contract performance. With the consent of the Contracting Officer and on terms approved by him, the Contractor may acquire or dispose of property to which title is vested in the Government pursuant to this clause, and in that event, the costs allocable to the property so transferred from this contract shall be eliminated from the costs of contract performance and the Contractor shall repay to the Government (by cash or credit memorandum) an amount equal to the unliquidated progress payments allocable to the property so transferred. Upon completion of performance of all the obligations of the Contractor under this contract, including liquidation of all progress payments hereunder, title to all property (or the proceeds thereof) which had not been delivered to and accepted by the Government under this contract or which had not been incorporated in supplies delivered to and accepted by the Government under this contract and to which title has vested in the Government under this clause shall vest in the Contractor. The provisions of this contract referring to or defining liability for Government-furnished property shall not apply to property to which the Government shall have acquired title solely by virtue of the provisions of this clause.

(e) *Risk of Loss.* Except to the extent that the Government shall have otherwise expressly assumed the risk of loss of property, title to which vests in the Government pursuant to this clause, in the event of the loss, theft or destruction of or damage to any such property before its delivery to and acceptance by the Government, the Contractor shall bear the risk of loss and shall repay the Government an amount equal to the unliquidated progress payments based on costs allocable to such lost, stolen, destroyed or damaged property.

(f) *Control of Costs and Property.* The Contractor shall maintain an accounting system and controls adequate for the proper administration of this clause.

(g) *Reports—Access to Records.* Insofar as pertinent to the administration of this clause, the Contractor will (i) furnish promptly such relevant reports, certificates, financial statements, and other information as may be reasonably requested by the Contracting Officer, and (ii) give the Government reasonable opportunity to examine and verify its books, records and accounts.

(h) *Special Provisions Regarding Default.* If this contract is terminated pursuant to the clause entitled "Default," (i) the Contractor shall, upon demand, pay to the Government the amount of unliquidated progress payments and (ii) with respect to all property as to which the Government elects not to require delivery under the clause entitled "Default," title shall vest in the Contractor upon full liquidation of progress payments, and the Government shall be liable for no payment except as provided by the "Default" clause.

(i) *Reservations of Rights.* The rights and remedies of the Government provided in this clause shall not be exclusive, and are in addition to any other rights and remedies provided by law or under this contract. No payment, or vesting of title pursuant to this clause, shall excuse the Contractor from performance of its obligations under this contract, nor constitute a waiver of any of the rights and remedies of the parties under this contract. No delay or failure of the Government in exercising any right, power or privilege under this clause shall affect any such right, power or privilege, nor shall any single or partial exercise thereof preclude or impair any further exercise thereof or the exercise of any other right, power or privilege of the Government.