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Contractual Arrangements Covering the Use of Government Property by Defense Contractors

Cover Page Footnote

Major, U.S.A.F.; member of the New York Bar.

CONTRACTUAL ARRANGEMENTS COVERING THE USE OF GOVERNMENT PROPERTY BY DEFENSE CONTRACTORS

JULES M. LIPTON*

I. INTRODUCTION

THE Army, Navy and Air Force spend billions of dollars each year for military hardware, and for research and development. For example, Congress appropriated \$2,520,000,000 for the procurement of Army equipment and missiles for the fiscal year ending June 30, 1963, while for the same year the Navy had over 3 billions available for aircraft and missiles alone, with several billions more set aside for building and converting ships, and for procuring other equipment and materials.¹ Together these two services were authorized to spend over 2½ billions for research, development, test and evaluation.²

The Air Force, of course, also has a large budget each year, and for the past three fiscal years has been allotted not less than 6½ billion dollars each year for the procurement of its weapons systems and other materiel.³ And for the fiscal year ending June 30, 1963, Congress provided it with \$3,632,100,000 for research and development.⁴

Defense procurement in its broadest sense, however, does not refer alone to the purchase of missiles, aircraft, ships, rifles, and research and development. The annual appropriation acts state that the billions earmarked for weapons and for research and development are also available for acquiring the land, plants, tools and equipment necessary to produce the weapons and perform the research.⁵ The military departments are, in fact, the owners of a huge estate of industrial property—real, personal and mixed—which is furnished to defense contractors for their use in performing government contracts.⁶ In addition, the Government owns and

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1. Department of Defense Appropriation Act, 1963, 76 Stat. 324 (1962).
2. 76 Stat. 326 (1962).
3. 76 Stat. 325 (1962); Department of Defense Appropriation Act, 1962, 75 Stat. 371 (1961); Department of Defense Appropriation Act, 1961, 74 Stat. 346 (1960).
4. Department of Defense Appropriation Act, 1963, 76 Stat. 326 (1962).
5. Department of Defense Appropriation Act, 1963, 76 Stat. 324 (1962); Department of Defense Appropriation Act, 1962, 75 Stat. 371 (1961); Department of Defense Appropriation Act, 1961, 74 Stat. 345 (1960). As discussed *infra*, the authority to provide research and development facilities at government expense is found in 10 U.S.C. § 2353 (1958). The annual appropriation acts simply provide that money appropriated for research and development may be used for the purposes of that statute.
6. The Department of the Air Force, for instance, has more than 3 billion dollars invested in industrial facilities in both government- and contractor-owned plants operated

frequently furnishes its contractors with material which is incorporated into the end items being produced, or which is expended during the performance of its contracts.

This article will examine the various contractual arrangements available to contractors who intend to use government facilities or other property in performing their contracts.

II. HISTORICAL CONSIDERATIONS

Shortly before our active participation in World War II, Congress recognized the vital need for a greatly expanded national industrial capacity, and granted broad authority to certain governmental agencies to acquire property and make it available to industry for use in furthering the national defense. Thus, in June 1940, the Reconstruction Finance Corporation was granted authority to create a subsidiary corporation with the power to acquire land, plants and equipment for the manufacture of "arms, ammunition, and implements of war," and "to lease such plants to private corporations to engage in such manufacture" And a month later, in "An act to expedite the strengthening of the national defense," the Secretary of War was authorized to provide for the construction of plants and related properties, and to arrange for their operation through contracts with selected qualified commercial manufacturers.⁸

As we moved through World War II and the Korean conflict, and into a continuing state of cold war, several statutes were enacted which dealt in one way or another with the matter of furnishing government-owned property to private contractors.

The Act of July 17, 1953, for example, authorized the Secretaries of the Army, Navy and Air Force, during the national emergency proclaimed on December 16, 1950, to acquire industrial plants, facilities, machine tools and similar property, and to provide for their maintenance, storage and operation "either by means of Government personnel or qualified commercial manufacturers under contract with the Government"⁹

by private contractors. This includes land, buildings, machine tools, and related production equipment. U.S.A.F., Report on Management of Industrial Facilities 1 (1963).

7. Act of June 25, 1940, ch. 427, § 5(2), 54 Stat. 573. The language of this enactment, although broad, was further broadened by an amendment a year later, as our involvement in the war deepened. Act of June 10, 1941, ch. 190, § 5, 55 Stat. 249. This amendment made it clear, *inter alia*, that the corporation's authority was not to be limited to leasing plants to private corporations, but included the power "to lease, sell, or otherwise dispose of such land, plants, facilities, and machinery to others to engage in such manufacture" *Ibid*.

8. Act of July 2, 1940, ch. 508, § 1, 54 Stat. 712.

9. Act of July 17, 1953, ch. 221, § 1, 67 Stat. 177. This authority was continued until July 1, 1957: Act of July 26, 1954, ch. 570, 68 Stat. 531; Act of Aug. 9, 1955, ch. 622, 69 Stat. 544; Act of June 21, 1956, ch. 420, 70 Stat. 325.

In 1947, the Senate Armed Services Committee recognized that the military departments had retained title to a group of munitions plants which had been financed by the Government at tremendous expense during the war. It was apparent that some uniform provision should be made whereunder these plants could be leased to private industry for such peacetime use as was possible.¹⁰ The Congress accordingly passed the Act of August 5, 1947,¹¹ which, as subsequently codified,¹² is the basic statute under which the secretaries of the military departments may lease real or personal property where doing so will promote the national defense or be in the public interest. This legislation restricts the term of a lease to five years unless the secretary concerned determines that a longer period is consistent with the statutory purpose, and it provides that the leases granted must be revocable in the event of a national emergency.¹³

As the means of preparing for and waging war have become more sophisticated, military research and development has grown into a clearly defined area of defense activity, with its own procurement authority,¹⁴ annual appropriations,¹⁵ regulations¹⁶ and personnel in charge.¹⁷ As might be expected, the matter of furnishing government-owned research and development property to defense contractors has received special legislative attention. Section 2353 of Title 10 of the United States Code provides that military research and development contracts "may provide for the acquisition or construction by, or furnishing to, the contractor, of research, developmental, or test facilities and equipment" at government expense.

III. POLICY

Before examining the contractual arrangements which have developed for furnishing government property to contractors, one point must be

10. U.S. Code Cong. Serv. 1592 (1947). "[B]etween 1940 and 1944 approximately 1,200 industrial plants were constructed by the Government. Their total cost exceeded \$14,000,000,000." U.S. Code Cong. Serv. 2291 (1948).

11. 61 Stat. 774 (1947).

12. 10 U.S.C. § 2667 (1958).

13. *Ibid.*

14. Contracts for experimental, developmental or research work may be negotiated, rather than procured by formal advertising. 10 U.S.C. § 2304(a)(11).

15. For the past several years a separate title of the annual Department of Defense Appropriation Act has been devoted to "research, development, test, and evaluation." See, e.g., Department of Defense Appropriation Act, 1963, 76 Stat. 326 (1962), and statutes cited note 5 *supra*.

16. The negotiation authority, 10 U.S.C. § 2304(a)(11), is implemented in Armed Services Procurement Reg. 3-211, 32 C.F.R. § 3.211 (1961).

17. The Department of Defense has a Director of Defense Research and Engineering directly under the Secretary and his Deputy, and each of the three military services has an Assistant Secretary for Research and Development. United States Government Organization Manual 580-83 (1962-1963).

made quite clear. Property will not be supplied to a contractor, regardless of the statutory authority therefor, unless furnishing the property is consistent with government procurement policy.

In the interest of furthering the free enterprise system and of permitting its agencies to concentrate their efforts on their primary objectives, the federal government buys what it needs from private industry.¹⁸ In so doing it is bound to deal only with "responsible" contractors, and this term means, *inter alia*, that the contractor must have the necessary facilities to produce the items being procured.¹⁹ The furnishing of facilities to government contractors is an exception to general policy, and in the case of contractors doing business with the Department of Defense, the limits and ramifications of this exception, as well as policy considerations relating to types of government-furnished property other than facilities, are carefully defined.²⁰

First of all, the Armed Services Procurement Regulations divide government property into three categories: material,²¹ special tooling,²² and industrial facilities.²³

Material is defined as "property which may be incorporated into or attached to an end item to be delivered under a contract or which may be consumed or expended in the performance of a contract."²⁴

18. Bureau of the Budget Bull., No. 60-2, Sept. 21, 1959.

19. Federal Procurement Regs., 41 C.F.R. §§ 1-1.310-4 to -5 (1963). The ability of the contractor to provide the necessary materials for the end items, as contrasted with the facilities to produce them, is not specifically referenced in the definition of "responsibility." The contractor must, however, be able to meet a definite delivery schedule and be otherwise able to perform the contract. *Ibid.*

20. It is not surprising that the Federal Procurement Regulations, which apply generally to all federal agencies and do not deal with this matter in detail, are not mandatory upon the Department of Defense. 41 C.F.R. § 1-1.004 (1963). As the dollar volume of defense procurement is far greater than that of any other single government agency, and as the procurement of military supplies and services is often highly complex, special rules have inevitably emerged. Procurement policies and procedures for the Department of Defense are set forth in the Armed Services Procurement Regulations, which each of the military services has in turn implemented, viz., Army Procurement Procedure, Navy Procurement Directives, and Air Force Procurement Instructions. The new (1961) Defense Supply Agency, charged with the management of supplies common to all of the military services (Dep't of Defense Directive 5105.22, Nov. 6, 1961) has also implemented the Armed Services Procurement Regulations with its own Defense Supply Procurement Regulation.

21. Armed Services Procurement Reg. 13-101.4, 32 C.F.R. § 13.101-4 (1961).

22. Armed Services Procurement Reg. 13-101.5, 32 C.F.R. § 13.101-5 (1961).

23. Armed Services Procurement Reg. 13-101.6, 32 C.F.R. § 13.101-6 (1961).

24. Armed Services Procurement Reg. 13-101.4, 32 C.F.R. § 13.101-4 (1961). "It includes, but is not limited to, raw and processed material, parts, components, assemblies, and small tools and supplies which may be consumed in normal use in the performance of the contract." *Ibid.*

Special tooling means all special equipment, acquired or manufactured by the contractor for use in the performance of the contract, which is of such a specialized nature that unless it is substantially modified or altered, its use is limited to production which is peculiar to the needs of the Government.²⁵

Industrial facilities are defined as property, other than material and special tooling, of use for the performance of a contract, including land, buildings and plant equipment.²⁶

In order to understand Defense Department policy and the various government property arrangements which may appear in defense contracts, an additional description of the property, in terms other than those just discussed, must be considered. Government property may, of course, be provided to a contractor by simply furnishing it to him. On the other hand, the Government may authorize the contractor to acquire the property for his use, but for the account of the Government. This distinction is recognized in the Armed Services Procurement Regulations. *Government-furnished property* is defined as property which is in the possession of the Government and is subsequently delivered to the contractor. *Contractor-acquired property*, on the other hand, is defined as property procured or otherwise provided by the contractor for the performance of a contract, under which title to the property is vested in the Government.²⁷ When a contract speaks of government property which is *provided to the contractor*, it refers to both kinds.

The Defense Department's general policy with respect to *materials* is that they will be furnished by the contractor.²⁸ The Government may supply them as an exception, however, if, for reasons of economy, standardization, or expediting production, it is in its best interest to do so.²⁹ It is not at all unusual, for example, for the Government to furnish cloth

25. Armed Services Procurement Reg. 13-101.5, 32 C.F.R. § 13.101-5 (1961). "The term does not include: (a) items of tooling or equipment acquired by the contract or prior to the contract, or replacements thereof, whether or not altered or adapted for use in the performance of the contract, (b) consumable small tools, or (c) general or special machine tools, or similar capital items." Ibid.

26. Armed Services Procurement Reg. 13-101.6, 32 C.F.R. § 13.101-6 (1961). Industrial facilities which cannot be removed without substantial loss of value or damage, either to the facilities or to the premises, are called nonseverables (Armed Services Procurement Reg. 13-101.8, 32 C.F.R. § 13.101-8 (1961)), and are discussed infra. This term is roughly equivalent to fixtures in real property law.

27. Armed Services Procurement Reg. 13-101.2, 32 C.F.R. § 13.101-2 (1961). The Supreme Court upheld the right of a military department to acquire property through a contractor in *Kern-Limerick, Inc. v. Scurlock*, 347 U.S. 110 (1954).

28. Armed Services Procurement Reg. 13-102.1, 32 C.F.R. § 13.102-1 (1961).

29. Ibid.

for uniforms,³⁰ or barrack bags,³¹ or foodstuffs to be processed into rations.³² In research and development contracts the Government often turns over metals or specialized fabrics for the contractor to expend in conducting the tests necessary to his investigations.³³

The policy on *special tooling* is just the opposite from that on material. Special tooling is usually expensive. As it can only be used to produce specialized government supplies and not commercial items, the contractor cannot be expected to furnish it as he does his ordinary plant equipment.³⁴ If he has to manufacture or acquire special tooling, he passes the cost on to the Government, not indirectly by way of a depreciation allowance in overhead as he would for his own general production equipment, but directly by including the cost of the special tooling as one of the elements which are considered in the price of the end items which he produces.³⁵ If the Government already owns the special tooling required for the performance of a contract, there is no reason why it should pay a contractor to produce or acquire it, and so the policy is for a military department which has special tooling to furnish it.³⁶ This policy, of course, will not control if furnishing the special tooling interferes with essential production or program schedules, or if it is less expensive to have the contractor furnish it.³⁷ Such matters as the cost of shipping government-owned tooling to the contractor's plant, the cost of adapting it to the particular requirements of the contract, the cost of any delays involved and the cost of new tooling must all be considered.³⁸

As far as *facilities* are concerned, the Defense Department expects its contractors to have available the industrial plant necessary to perform

30. See, e.g., Michael A. Zielinski Co., A.S.B.C.A. 2454, 60-1 B.C.A. ¶ 2519 (1960); Acme Sportswear Co., A.S.B.C.A. 4509, 59-1 B.C.A. ¶ 2082 (1959).

31. See, e.g., Lilley-Ames Co. v. United States, — Ct. Cl. —, 293 F.2d 630 (1961).

32. Pacific Grape Prods. Co., A.S.B.C.A. 2527, 58-2 B.C.A. ¶ 1861 (1958).

33. Where nuclear materials are furnished, the Air Force requires the contractor to develop control procedures which are consistent with the requirements of both the Air Force and the Atomic Energy Commission regarding health, safety, security and accountability.

34. The term "plant equipment" means "personal property of a capital nature (consisting of machinery, equipment, furniture, vehicles, machine tools, and accessory and auxiliary items, but excluding special tooling) used or capable of use in the manufacture of supplies or in the performance of services or for any administrative or general plant purpose." Armed Services Procurement Reg. 13-101.9, 32 C.F.R. § 13.101-9 (1961).

35. The special contractual arrangement covering special tooling will be discussed *infra*. If the contractor is paid his costs (with or without a fee) rather than a fixed price, he is reimbursed for the cost of the special tooling he has acquired.

36. Armed Services Procurement Reg. 13-102.2, 32 C.F.R. § 13.102-2 (1961).

37. *Ibid.*

38. *Ibid.*

their contracts.³⁹ Furnishing industrial facilities, like furnishing materials, is an exception to general policy,⁴⁰ and the procuring agencies of the Department are prohibited from including in their competitive solicitations an offer to furnish industrial facilities, or to have a contractor acquire them for the agency's account.⁴¹ In certain cases, however, the general policy may not be expressive of the Government's best interest, and where this is so, industrial facilities may be supplied to contractors.

For example, if contract performance cannot be obtained without the use of government-owned facilities, or if using the contractor's facilities would result in allocating excessive depreciation costs to the contract, the Government may furnish industrial facilities.⁴² It may also furnish them where doing so will result in the end item costing the Government substantially less than it otherwise would.⁴³

IV. CONTRACTUAL ARRANGEMENTS GENERALLY

Contractual arrangements covering the use by a contractor of government property in the performance of his contract vary as to both form and substance. Sometimes the arrangements are completely set forth in the procurement contract, and sometimes they are only mentioned in that contract but set out in another instrument. Sometimes the arrangements provide for the contractor to bear the risk of loss if the property is destroyed, and sometimes they provide for the Government to bear the risk. Sometimes the Department of Defense requires that the property be controlled according to one set of rules, and sometimes it requires control under another set.

Although there are many factors which come into play in determining how the use of government property by a contractor will be covered contractually, the provisions ultimately agreed to spring generally from the kind of property involved (*i.e.*, materials, special tooling, or industrial facilities), and whether the contractor is to be paid a fixed price, or whether he is to be paid his costs with or without an accompanying fee.

As will appear in the following discussion, such matters as whether the contract resulted from formal advertising or negotiation,⁴⁴ whether

39. Armed Services Procurement Reg. 1-903.2, 32 C.F.R. § 1.903-2 (1961). See also Air Force Procurement Instruction 13-2402, 32 C.F.R. § 1013.2402 (1963).

40. Armed Services Procurement Reg. 13-102.3, 32 C.F.R. § 13.102-3 (1961), as amended, 32 C.F.R. § 13.102-3 (Supp. 1963).

41. *Ibid.*

42. *Ibid.*

43. *Ibid.*

44. Formal advertising is the basic method by which the Department of Defense

or not it is with a nonprofit institution, and the dollar value of the property being furnished, also bear upon the exact clauses which will be used.

Where one of the military services and a contractor agree that government-owned material or special tooling will be furnished the contractor for use in the performance of his contract, the written embodiment of this agreement usually is contained in one of the clauses of the contract. This clause is implemented by a description of the property, only in such detail as is necessary for identification, in the schedule part of the contract.⁴⁵ Where industrial facilities are being made available, however, the provisions controlling the rights and obligations of the parties will probably be contained in a separate facilities contract or lease, rather than in a clause of the basic contract, and this is also true where property is placed in the hands of the contractor under a bailment agreement. The simplest form of arrangement, however, is one where the property is furnished to the contractor in accordance with a clause in the basic contract, and this will be discussed first.

V. THE GOVERNMENT-FURNISHED PROPERTY CLAUSES

The Armed Services Procurement Regulations prescribe several clauses covering government-furnished property, and if one or another of them is applicable to the contractual situation at hand, it must be used.⁴⁶ In addition, the individual services have in certain instances devised their

procures supplies and services. 10 U.S.C. § 2304 (1958), as amended, 10 U.S.C. § 2304 (Supp. IV, 1963). It means procurement by competitive bids followed by an award, after public opening of the bids, to "that responsible bidder whose bid, conforming to the invitation for bids, will be most advantageous to the Government, price and other factors considered." Armed Service Procurement Reg. 2-101, 32 C.F.R. § 2.101 (1961). Negotiation of contracts is permitted in seventeen situations set forth in 10 U.S.C. § 2304 (1958), as amended, 10 U.S.C. § 2304 (Supp. IV, 1963). Although negotiation is technically an exceptional method of procurement, it in fact accounts for the largest dollar volume by far of defense contracts.

45. Broadly speaking, a government contract is divided into three parts, viz., the schedule, the general provisions and the exhibits. The schedule contains the factual details of the contract, and spells out such matters as the work to be performed, the delivery schedule, the consideration, where inspection and acceptance will take place, and, *inter alia*, what government property will be furnished. The general provisions, commonly called "boiler plate," consist of clauses, such as the government-furnished property clause, setting forth the rights and obligations of the parties; and the exhibits contain matters referred to in the schedule, but too detailed to be set out at length therein.

46. These clauses are contained in Armed Services Procurement Regs. 13-502 to -508, 32 C.F.R. §§ 13.502 to .508 (1961), as amended, 32 C.F.R. §§ 13.502 to .508 (Supp. 1963). See Goodwin, *Government-Furnished Property* (Government Contracts Monograph No. 6, George Washington University, 1963) for an excellent detailed examination of these clauses.

own clauses. These are basically the same as those set forth in the Armed Services Procurement Regulations and hence do not contravene the regulations, but are used in special situations not specifically covered in the regulations.⁴⁷ All of the clauses, whether prescribed by the Armed Services Procurement Regulations or devised by the individual services, have in common certain fundamentals which arise naturally and equitably from the very nature of the government-furnished property situation. They differ only insofar as it is necessary to accommodate variations in that situation.

A. *Equitable Adjustment*

First of all, the government-furnished property clause (or "government property clause" as it is called in cost contracts) provides that the Government shall deliver the property described in the schedule or specifications of the contract.⁴⁸ It goes on to state that the property should be "suitable for use," and must be delivered at the time set forth in the schedule, or if none is set forth, in time for the contractor to meet his delivery schedule.⁴⁹

If the government property delivered is not suitable for its intended use, the contractor has the right under the clause either to return it, or to repair or modify it. If he does any of these, the Government's contracting officer must make such equitable adjustments as are appropriate in the delivery schedule, the contract price and any other contractual provision affected.⁵⁰

Similar adjustments must be made under the clause if the property is not delivered in time for the contractor to perform in accordance with his obligation under the contract,⁵¹ although the contractor is not

47. E.g., Army Procurement Procedure 13-502.50, 32 C.F.R. § 602.502-50 (1962), and Air Force Procurement Instruction 7-602.51, 32 C.F.R. § 1007.602-51 (1963), contain clauses for fixed price construction contracts with the Army and Air Force respectively.

48. Armed Services Procurement Regs. 13-502 to -504, -506, 32 C.F.R. §§ 13.502 to .504, .506 (1961), as amended, 32 C.F.R. §§ 13.502 to .504, .506 (Supp. 1963). The clauses also require delivery of "such related data and information as the Contractor may request and as may reasonably be required for the intended use of such property . . ." Ibid.

49. Ibid.

50. Ibid.

51. Ibid. A price adjustment for delay in the delivery of government-furnished property, however, is not uniformly provided for in all contracts of the military services. For example, there have been Navy contracts which expressly provided that the Government would not be liable for increased costs resulting from such delay, and the Armed Services Board of Contract Appeals has upheld such disclaimers. *Ken's Elec. Co.*, A.S.B.C.A. 7750, 62 B.C.A. ¶ 3507 (1962); *Croft-Mullins Elec. Co.*, A.S.B.C.A. 6113, 61-1 B.C.A. ¶ 2922 (1961). Cf. *Ozark Dam Constructors v. United States*, — Ct. Cl. —, 288 F.2d 913 (1961), where the public policy aspects of a similar provision are considered.

excused from performing until such adjustments are made.⁵²

So strong is the policy underlying the right of a contractor to an equitable adjustment, where the military services fail to meet their government-furnished property commitments, that the Armed Services Board of Contract Appeals has held a contractor entitled to a price adjustment for late delivery of property, even though the government-furnished property clause was not in the contract at the time of the delivery, but was added a year later.⁵³ The Board reasoned that as the parties had intended to comply with the Armed Services Procurement Regulations which required that the clause be in the contract, when it was finally included in the contract it would be given retroactive effect.⁵⁴

Whether the government-owned property delivered to the contractor is "suitable for use" is, of course, a question of fact, but the Board of Contract Appeals and the Court of Claims have developed certain aspects of this matter so that some feeling for the meaning of the term and its limits is possible.

In the first place, if the property does not measure up to certain applicable specifications, it is not considered suitable for its intended use.⁵⁵ But even if it does meet these specifications, the property will still be considered unsuitable if the contractor finds that it cannot in fact be used in the manufacturing process which is customarily followed in producing the item contracted for.⁵⁶ So a contractor was held entitled to an equitable adjustment in the contract price where he experienced increased costs in working with government-furnished cloth, which met military specifications, but which had too hard a finish to be folded and sewn in the usual way.⁵⁷ In another case, a contractor was held entitled to costs incurred in sorting, straightening and identifying government-furnished parts from which numbers were missing.⁵⁸

In other words, suitability is not measured alone by some intrinsic quality of the property itself.⁵⁹ It depends rather upon whether the property can be used as the parties intended it to be used in the per-

52. Republic Electronic Indus. Corp., A.S.B.C.A. 3788, 4478, 59-1 B.C.A. ¶ 2139 (1959).

53. Worman-Pillifant Co., A.S.B.C.A. 6618, 61-2 B.C.A. ¶ 3129 (1961).

54. *Id.* at 12, 61-2 B.C.A. at 16,244.

55. Eveready Embroidery, Inc., A.S.B.C.A. 6773, 61-2 B.C.A. ¶ 3247 (1961) (cloth for insignia measured less than specified width).

56. Topkis Bros. Co. v. United States, — Ct. Cl. —, 297 F.2d 536 (1961), motion for reconsideration overruled, — Ct. Cl. —, 299 F.2d 952 (1962).

57. *Ibid.*

58. C. W. White Builders, Inc., A.S.B.C.A. 6655, 62 B.C.A. ¶ 3336 (1962).

59. If government-furnished cloth has such toxic qualities that it will cause rashes, it is, of course, unsuitable. See Hudson Garment Co., A.S.B.C.A. 4847, 60-2 B.C.A. ¶ 2827 (1960).

formance of the contract. After all, the contract price, delivery schedule and other essentials of the contract are arrived at with the understanding that the Government will furnish certain property. If the property which is furnished cannot be used, the contract essentials should be changed accordingly. Or, looked at from a different viewpoint, if the contract essentials should, in justice, be altered because extraordinary expenses or delays resulted from the contractor's using the property, the property will be considered unsuitable.⁶⁰

As for the actual contract adjustment which will be allowed in the event of unsuitability or late delivery, the clause says only that it must be equitable. Where increased costs are being contended, this of course means that they must have resulted from the Government's failure, and whether they did or not depends upon the case.⁶¹ The indirect labor costs of supervisory personnel, as well as reimbursement for additional rent which the contractor had to pay, have been allowed where these costs resulted from the Government's delay in delivering components for rations to be assembled by the contractor.⁶² But only the actual handling costs resulting from incorrectly labeled government-furnished cloth were allowed in another case, despite the contractor's claim that certain other costs also resulted from the mislabeling.⁶³ It should not be overlooked that legal and accounting expenses incurred in presenting a claim to the government contracting officer are properly included as part of the equitable adjustment.⁶⁴

Where increased costs are not being contended, but the contractor simply wants an extension of the delivery schedule, he may, as noted above, have such an extension as is equitable under the circumstances.

The remedy of equitable adjustment is exclusive, and the government-furnished property clause provides that "the Government shall not be liable to suit for breach of contract by reason of any delay in delivery of Government-furnished Property or delivery of such property in a condition not suitable for its intended use."⁶⁵

60. So the Armed Services Board of Contract Appeals found government-furnished stock numbers not suitable for intended use, when the contractor experienced unanticipated costs because the numbers were unusable for requisitioning parts as intended by the parties. *Lewis Motor Co.*, A.S.B.C.A. 6235, 6236, 61-1 B.C.A. ¶ 3032 (1961). And relief was also granted a contractor who had to perform extra work in order to meet performance requirements, when he built certain equipment in accordance with a government-furnished model. *Seaview Elec. Co.*, A.S.B.C.A. 6966, 61-2 B.C.A. ¶ 3151 (1961).

61. *Lake Union Drydock Co.*, A.S.B.C.A. 3073, 59-1 B.C.A. ¶ 2229 (1959).

62. *Van Brode Milling Co.*, A.S.B.C.A. 4289, 59-2 B.C.A. ¶ 2456 (1959), *aff'd*, 60-1 B.C.A. ¶ 2597 (1960).

63. *Acme Sportswear Co.*, A.S.B.C.A. 4509, 59-1 B.C.A. ¶ 2082 (1959).

64. *Lake Union Drydock Co.*, A.S.B.C.A. 3073, 59-1 B.C.A. ¶ 2229 (1959).

65. *Armed Services Procurement Reg. 13-502*, 32 C.F.R. § 13.502 (1961), as amended, 32 C.F.R. § 13.502 (Supp. 1963).

Sometimes the Government contracts to have certain items of equipment modified, repaired, reconditioned or the like, under a contract which estimates the number of items to be delivered to the contractor for processing, but does not bind the Government to deliver a set number. In such a case, even though the Government is not bound by the terms of the contract to deliver a set amount, or any amount beyond its requirements, the Armed Services Board of Contract Appeals has held on two occasions that the contractor is entitled to an equitable adjustment where the Government does not deliver the estimated number of items.⁶⁶ As a result of these decisions the Air Force has made two provisions. First, the schedule in such contracts is required to "identify the 'Air Force equipment upon which work is to be performed' as distinct from government-furnished property to be used in the performance of such work."⁶⁷ Then a special clause, relating only to the equipment upon which work is to be performed, is prescribed which makes substantially all of the provisions of the government-furnished property clause applicable to this equipment, *except the provisions for equitable adjustment discussed above*.⁶⁸ Excepting these provisions seems reasonable. Under this kind of contract the government property which is furnished is to be modified or repaired, so the question of its suitability does not really arise. Nor does there seem to be a question of late delivery hindering the contractor's performance, as all the contractor must do is modify or repair what is delivered to him.

Neither the other services nor the Defense Supply Agency seem to have made this special arrangement.

B. Title

Another fundamental contractual aspect of the government-furnished property situation is the agreement of the parties that title to the property shall remain in the Government. This is expressly provided for in the government-furnished property clause, which also states that the Government's title shall not be affected by the property being attached to or incorporated into any other property not owned by the Government.⁶⁹ In research and development contracts with nonprofit institutions, provision is made whereby title may be transferred to the con-

66. Mustang Sheet Metal & Mfg. Co., A.S.B.C.A. 2655 (1956); Flying Tiger Line, Inc., A.S.B.C.A. 2060 (1954).

67. Air Force Procurement Instruction 7-4051, 32 C.F.R. § 1007.4051 (1963).

68. *Ibid.* The Air Force Procurement Instruction section covers another variation, involving repair or modification contracts, which is beyond the scope of this article.

69. *Ibid.* The clauses even state that the government-furnished property cannot become a fixture by reason of its affixation to any realty.

tractor, provided he agrees not to charge for depreciation, amortization, or use of such property in any government contract.⁷⁰

In cost contracts, *i.e.*, contracts where the contractor is paid the costs he incurs in performing,⁷¹ with or without a fee, the government property clause⁷² makes an additional provision with respect to title. The Government is bound under such a contract to pay (through its reimbursement of the contractor) for any property which the contractor acquires or produces in the performance of the contract. This being so, the Government should take title to such property, and the clause provides that it does. In the case of property which the contractor acquires, title passes to the Government when the property is delivered to the contractor. In the case of other property, title passes when the property is committed to the contract,⁷³ or when the contractor is reimbursed the cost of it, whichever occurs first.

Both the property furnished by the Government and this other property to which the Government takes title during the course of the contract are collectively called "government property" in a cost contract, and the provisions of the government property clause apply to both of them without distinction.⁷⁴

C. Risk of Loss

The question of who bears the risk of loss while government property is in the hands of a contractor is, of course, covered in the government-furnished property clause, which treats the matter in considerable detail. There are several different arrangements.

In a fixed-price contract which was entered into as a result of formal advertising, the contractor bears the risk of loss or damage to any property furnished him by the Government. He is not responsible for reason-

70. Armed Services Procurement Regs. 13-505, -506, 32 C.F.R. §§ 13.505, .506 (1961), as amended, 32 C.F.R. §§ 13.505, .506 (Supp. 1963). This provision and Armed Services Procurement Reg. 4-214.4, 32 C.F.R. § 4.214-4 (Supp. 1963), implement the authority contained in 72 Stat. 1793, 42 U.S.C. § 1892 (1958), to vest title to research and development equipment in nonprofit institutions.

71. He is not, of course, paid all of his costs—only those that are allowable in accordance with the rules set forth in § 15 of the Armed Services Procurement Regulations.

72. As indicated above, the clause is entitled "Government Property" in cost contracts, and "Government-Furnished Property" in fixed-price contracts.

73. The language of the clause is that title shall vest in the Government "upon (i) issuance for use of such property in the performance of this contract, or (ii) commencement of processing or use of such property in the performance of this contract" Armed Services Procurement Reg. 13-503, -506, 32 C.F.R. §§ 13.503, .506 (1961), as amended, 32 C.F.R. §§ 13.503, .506 (Supp. 1963).

74. Armed Services Procurement Regs. 13-503, -506, 32 C.F.R. §§ 13.503, .506 (1961), as amended, 32 C.F.R. §§ 13.503, .506 (Supp. 1963).

able wear and tear, however, and of course he is not responsible for government property which is consumed in the performance of the contract.⁷⁵

If the fixed-price contract was negotiated, as distinguished from being entered into as a result of formal advertising, the risk of loss or damage generally falls upon the Government.⁷⁶ In other words, in this situation the Government acts as a self-insurer.

The Government's role of self-insurer is, however, limited in certain respects. For one thing, the Government does not underwrite any loss, destruction or damage which results from willful misconduct or lack of good faith on the part of the contractor's managerial personnel in caring for the government property.⁷⁷

The Government's responsibility does extend to losses caused by any peril while the property is in transit off the contractor's premises.⁷⁸ And it also extends to a list of named perils which one would expect to find if the contractor had an insurance policy covering the property, *e.g.*, fire, lightning, windstorm, cyclone, riot, vandalism, etc. Furthermore, it even extends to perils which are not listed "if such other peril is customarily covered by insurance (or by a reserve for self-insurance) in accordance with the normal practice of the Contractor, or the prevailing practice in the industry in which the Contractor is engaged with respect to similar property in the same general locale."⁷⁹

But the liability for a loss which results neither from the contractor's misconduct nor from an in-transit peril, named peril, or other peril customarily insured against, is not clear.

The government-furnished property clause, while broadly making the Government a self-insurer, is written in a form exculpatory to the contractor. It states that *except* for losses caused by the contractor's mis-

75. Armed Services Procurement Reg. 13-502, 32 C.F.R. § 13.502 (1961), as amended, 32 C.F.R. § 13.502 (Supp. 1963).

76. *Ibid.*

77. Managerial personnel are defined as directors, officers and managers who supervise either all of the contractor's business, all of his operation at any one plant where the contract is being performed, or who supervise a separate major industrial operation in connection with the performance of the contract. Armed Services Procurement Regs. 13-502, -503, 32 C.F.R. §§ 13.502, .503 (1961), as amended, 32 C.F.R. §§ 13.502, .503 (Supp. 1963).

78. In *Oliver-Finnie Co., A.S.B.C.A. 1471* (1954), the Armed Services Board of Contract Appeals held the contractor not liable for the value of beetle-infested cookies and crackers furnished by the Government for assembly into combat rations, where it appeared that the infestation originated while the cookies and crackers were in transit to the contractor's plant in railroad cars.

79. Armed Services Procurement Reg. 13-502, 32 C.F.R. § 13.502 (1961), as amended, 32 C.F.R. § 13.502 (Supp. 1963).

conduct, he *shall not* be liable for losses caused in certain specified ways, *i.e.*, by any peril in transit, by certain named perils, by other perils customarily covered by insurance. What about losses caused in other ways: is the contractor liable for them?

Certain language in the clause tends to support the position that he is liable, as an insurer, for such losses.

The clause says that except for losses for which the contractor is expressly relieved of liability, and except for reasonable wear and tear, the property shall be returned in as good condition as when received by the contractor.⁸⁰ As far as the words of the clause are concerned, he must make this return of the property, whether or not he exercised due care while he was in possession of it.

Furthermore, as the Government is, generally speaking, a self-insurer under the contract, it requires the contractor to represent that he is not including insurance charges or reserves in his price. But the wording of this representation is *not* that the contractor is not charging for *any* insurance; it is only that he is not charging for insurance covering losses for which he is expressly relieved of liability. There is nothing to prevent him from including in his price charges for insurance covering other losses, and this may indicate that the parties intended him to be an insurer of such other losses.

At least one case interpreted the risk of loss section of the clause as making the contractor an insurer.⁸¹ In this case, the government property had been stolen, despite the contractor's due care, and the predecessor of the present Armed Services Board of Contract Appeals found the contractor liable on the ground that the clause increased his common-law liability as a bailee, and made him an insurer against those losses not specifically set out in the government-furnished property clause.

On the other hand, in a more recent case⁸² the present Board found the contractor not liable for the loss of government-owned cereal blocks which were infested by beetles and moth larvae while they were in storage at the contractor's plant, on the ground that the contractor used that degree of care required of it under the law. The Board observed that the "courts are reluctant to enlarge . . . the generally accepted rules of bailment and will do so only pursuant to a manifest intention of the parties," which intention is not expressed in the government-furnished property clause. The question is thus unresolved.⁸³

80. *Ibid.*

81. *Higgins Plastics Corp.*, W.D.B.C.A. 1443, 4 C.C.F. ¶ 60324 (1947).

82. *Pacific Grape Prods. Co.*, A.S.B.C.A. 2527, 58-2 B.C.A. ¶ 1861 (1958).

83. Other cases touching on this matter are discussed in Goodwin, *op. cit. supra* note 46, at 29.

The question of who bears the risk of loss in a cost contract is much simpler. The clause used in such contracts relieves the contractor of liability for any loss or damage to government property, except that which results from willful misconduct or lack of good faith on the part of the contractor's managers, or which results from risks against which the contractor is either insured, or required to be insured under the contract.⁸⁴ As a necessary corollary to this, the clause provides that the contractor shall not be reimbursed for the cost of any insurance, except that which the Government required him to carry under the contract.⁸⁵

In research and development contracts with nonprofit institutions, liability for loss or damage is the same as that just discussed for cost contracts, regardless of whether the research and development contract is of the cost or fixed-price type.⁸⁶

Government property is frequently placed in the hands of subcontractors, and the government-furnished property clause provides that the clause shall not be construed as relieving a subcontractor of liability for loss or damage to government property, except to the extent that the subcontract may provide for such relief.⁸⁷ This relief may not be accorded a subcontractor, however, without the prior approval of the government contracting officer, and if approval is not obtained, the subcontract must require that the property be returned in as good condition as when it was received, except for fair wear and tear or utilization of the property under the provisions of the prime contract. Furthermore, if the subcontractor has not been relieved of liability, the prime contractor is obligated to enforce the subcontractor's liability for the benefit of the Government.⁸⁸

D. *Other Provisions*

In addition to the matters discussed, the prescribed clauses dealing with government property set forth the contractor's responsibility to maintain and control the property,⁸⁹ and describe in some detail what

84. Armed Services Procurement Reg. 13-503, 32 C.F.R. § 13.503 (1961), as amended, 32 C.F.R. § 13.503 (Supp. 1963).

85. *Ibid.*

86. Armed Services Procurement Regs. 13-505, -506, 32 C.F.R. §§ 13.505, .506 (1961), as amended, 32 C.F.R. §§ 13.505, .506 (Supp. 1963). It should also be noted that the fixed-price research and development clause makes no distinction between advertised and negotiated contracts as does the regular fixed price clause. Research and development contracts with nonprofit institutions are in fact almost always negotiated under 10 U.S.C. § 2304(a)(5) (1958).

87. Armed Services Procurement Regs. 13-502, -503, 32 C.F.R. §§ 13.502, .503 (1961), as amended, 32 C.F.R. §§ 13.502, .503 (Supp. 1963). Both the fixed-price and cost-reimbursement clauses make the same provision with respect to subcontractors.

88. *Ibid.*

89. The Armed Services Procurement Regulations contain two manuals covering the

the contractor must do in the event the property is lost, damaged or destroyed. The clauses also set forth the procedure to be followed upon completion of the contract, and, *inter alia*, state certain other fundamental propositions, *e.g.*, that the government property may be used only in the performance of the contract at hand, that the contracting officer may decrease the amount of government property to be furnished provided he makes equitable adjustments accordingly,⁹⁰ and that the Government shall have access to the premises where the property is located.

E. Short-Form Clauses

The government-furnished property clause is over 2,000 words long, and, as has been seen, covers in considerable detail the legal consequences of turning government property over to contractors. The Army, Navy, and Defense Supply Agency have recognized that in certain cases where a contract is for a small dollar amount, or where the property to be furnished is low in value, it is to the Government's advantage to cover the transaction with a short, simple clause.

Accordingly the Army requires a short-form clause to be used in fixed-price contracts which are not in excess of \$1,000, and in contracts for the construction or repair of buildings and other real property where the value of the property being furnished is not in excess of \$1,000.⁹¹ The clause contains but three short paragraphs, providing that (1) the Government shall deliver the specified property to the contractor for use under the terms of the contract; (2) title to the property shall remain in the Government, and the contractor shall control the property in accordance with the Armed Services Procurement Regulation Manual;⁹² and (3) except for reasonable wear and tear, or use under the contract, the contractor shall be liable for loss, destruction or damage to the property.⁹³

control of government property which is in the possession of contractors. One applies to contractors generally (appendix B) and one applies specifically to nonprofit research and development contractors (appendix C). These appendices are incorporated by reference into the various government property clauses.

90. In cost-reimbursement supply contracts provision for changing the amount of government property is found in the "Changes" rather than in the government property clause of the contract. Armed Services Procurement Reg. 7-203.2, 32 C.F.R. § 7.203-2 (1961). In cost-reimbursement research and development contracts the provision for changing amount is also found in the "Changes" clause (Armed Services Procurement Reg. 7-404.1, 32 C.F.R. § 7.404-1 (1961)), but the government property clause for such contracts also provides that the Government may deliver to the contractor property in addition to that set forth in the contract. Armed Services Procurement Reg. 13-406, 32 C.F.R. § 13.406 (1961), as amended, 32 C.F.R. § 13.406 (Supp. 1963).

91. Army Procurement Procedure 13-550, 32 C.F.R. § 602.550 (1962).

92. See note 89 *supra*.

93. Army Procurement Procedure 13-550, 32 C.F.R. § 602.550 (1962).

The Defense Supply Agency makes a similar clause available under the same circumstances, but unlike the Army, does not require it to be used.⁹⁴

The Navy version of a short-form clause is somewhat different. It applies only to government-furnished *material* (as distinguished from facilities and special tooling) which is either to be incorporated into the end product or consumed in the performance of the contract, and the material may be worth up to \$5,000.⁹⁵ The Air Force does not have a short-form clause.

VI. SPECIAL TOOLING

As discussed above, government property is divided into three categories, *viz.*, material, special tooling, and facilities—and special tooling refers to equipment of such a specialized nature that, unless it is substantially modified or altered, it can be used only in the production which is peculiar to the needs of the Government.⁹⁶

If government-owned special tooling is furnished to a contractor, it is covered by the government-furnished property clause already discussed, or one of its variations, just as is any other government-furnished property. Where, however, special tooling is required for the performance of a contract, and for one reason or another it is not to be furnished by the Government,⁹⁷ the Armed Services Procurement Regulations provide that it may be furnished or acquired by the contractor.⁹⁸ If this is to be done, the contract may provide for the tooling to be delivered by the contractor as one of the end items of the contract, in which case the rights and obligations of the parties with respect to it are the same as they are with respect to any other end item to be delivered.⁹⁹

Where, however, special tooling is to be provided by the contractor,

94. Defense Supply Procurement Reg. 13-550 (1962).

95. Navy Procurement Directive 13-502.50 (1959).

96. Generally speaking, special tooling refers to "jigs, dies, fixtures, molds, patterns, special taps, special gauges, special test equipment, other special equipment and manufacturing aids, and replacements thereof. . . ." Armed Services Procurement Reg. 13-101.5, 32 C.F.R. § 13.101-5 (1961).

97. The Government may not own the special tooling required, or if it does, may not wish to furnish it as a matter of policy, e.g., if furnishing it interferes with essential production.

98. Armed Services Procurement Reg. 13-302, 32 C.F.R. § 13.302 (1961).

99. *Ibid.* Under a recent change to the Armed Services Procurement Regulations, if the procurement is to be accomplished by formal advertising (as distinguished from negotiation), and if special tooling is to be furnished or acquired by the contractor, it must be an end item under the contract; no alternative is possible. At the time of writing, this change had not yet appeared in the Armed Services Procurement Regulations, but was announced in Air Force Procurement Circular No. 33 (April 30, 1963).

but is not to be delivered as one of the end items, a special arrangement is necessary. On the one hand, the contractor is being paid directly for the tooling, because a factor covering it is included in the price of the contract. This, of course, is as it should be: the contractor is required to provide special production equipment which he would not normally have as part of his plant, and which he cannot use except for government work. He should be paid for furnishing such equipment. On the other hand, the Government is paying for something which it does not want as an end item under the contract, and which the contractor is not required to deliver.

A special-tooling clause¹⁰⁰ has been devised which outlines, step by step, the procedure to be followed by both the contractor and the Government, in order to assure a fair and sensible resolution of the problem.

Under this clause the Government and the contractor arrange for the decision as to disposition of the tooling to be postponed, at least until deliveries begin. At this time the special tooling used in producing the end items is in being, and the Government and the contractor can decide, which they could not do at the outset, what to do.

Some time after deliveries begin,¹⁰¹ the contractor sends the government contracting officer a list of all the special tooling which he acquired or manufactured. The list may be accompanied by an offer to retain the tooling, free of any government interest, for a fair amount.

The contracting officer then tells the contractor which items of special tooling the Government wants, and he requests the contractor to transfer title to these items, and deliver them. If the contractor made an offer to retain certain items for a price, the contracting officer accepts, rejects, or asks for further negotiation regarding the offer.

If neither the Government nor the contractor wants the special tooling, the contracting officer may either direct the contractor to sell it as scrap for the Government's account, or he may simply waive any further rights of the Government to it.

In addition to certain other requirements flowing from the basic arrangement just discussed, the clause provides that the contractor may not use the tooling in the performance of any other contract¹⁰² unless

100. Armed Services Procurement Reg. 13-504, 32 C.F.R. § 13.504 (1961), as amended, 32 C.F.R. § 13.504 (Supp. 1963).

101. This may be as early as 60 days after delivery of the first items, or as late as the completion of the contract. Armed Services Procurement Reg. 13-504, 32 C.F.R. § 13.504 (1961), as amended, 32 C.F.R. § 13.504 (Supp. 1963).

102. By definition, special tooling is of such a specialized nature that without substantial modification or alteration, its use is limited to government work. Armed Services Procurement Reg. 13-101.5, 32 C.F.R. § 13.101-5 (1961). The regulation provides that if a contractor must acquire tooling which would be "special tooling" except that it has commercial

he obtains the contracting officer's approval. With this approval he may use the tooling on other government contracts, provided he agrees not to charge those contracts with any special-tooling costs already charged to the contract under which he acquired the tooling.

Before leaving the special-tooling clause we should note that the clause is not applicable in cost contracts. There, if the contractor acquires special tooling it becomes government property immediately, and subject to the government property clause.

VII. FACILITIES CONTRACTS

Thus far the arrangements discussed have been ones which are embodied in clauses of the basic procurement contract between the Government and the contractor. Early in this discussion, however, we noted that sometimes the arrangements concerning government property are only mentioned in the procurement contract, but are set out in a separate instrument. This is the case where the government property is industrial facilities.

The Armed Services Procurement Regulations require that, with certain exceptions, a facilities contract, separate from any related contract for supplies or services, be entered into where industrial facilities are provided to a contractor.¹⁰³ Broadly speaking, this facilities contract covers the same ground as the government-furnished property clauses discussed above, and the procurement contract which is based upon providing the contractor with the facilities contains references of one sort or another which tie the two contracts together. Generally, all of the government-provided industrial facilities which a contractor has at any one plant or general location are covered by a single facilities contract.¹⁰⁴

As already observed, government property provided to a contractor may be furnished by the Defense Department agency concerned, or it may be acquired by the contractor with a provision for title to vest in the Government. One aspect of this latter situation was touched upon in our consideration of the government property clause in cost contracts, where we saw that title to property acquired by the contractor in the

use, the contract may allow for this acquisition "giving due consideration to the best interests of the Government and the equities of the contractor." Armed Services Procurement Reg. 13-306, 32 C.F.R. § 13.306 (1961).

103. Armed Services Procurement Reg. 13-402, 32 C.F.R. § 13.402 (1961). The exceptions are when: (1) the acquisition cost of the facilities does not exceed \$50,000, (2) the contract is for construction work, (3) the contract is for work at a government installation, or (4) the contract is for service involving the operation of a government-owned plant or installation. *Ibid.*

104. Armed Services Procurement Reg. 13-403, 32 C.F.R. § 13.403 (1961).

performance of the contract, and for which he was entitled to be reimbursed, passed to the Government.

The fact that both government-furnished and contractor-acquired property may comprise the property provided to a contractor is of particular significance in connection with facilities. It is true that where a contractor makes or buys material (property which will be expended in performance or become part of the end items) under a cost contract, the material meets the definition of contractor-acquired property, but when the contract is completed, either the material has been expended or it is part of an end item. Where facilities are acquired, however, their acquisition, although related to one or more procurement contracts for supplies or services, is accomplished as a requirement separate from the performance of the procurement contracts, and the character of the property as facilities extends beyond the completion of those contracts. The separate facilities contract required by the Armed Services Procurement Regulations, then, must cover both facilities already in the government inventory which are being furnished to the contractor, as well as facilities which the contractor is to acquire at government expense for his use in performing his procurement contracts.

Although the Armed Services Procurement Regulations do require a separate facilities contract, and do state that each such contract must provide for title to facilities furnished to the contractor to remain in the Government, and for title to facilities acquired by him to vest in the Government "at the earliest practicable time,"¹⁰⁵ the way in which it covers government-furnished and contractor-acquired property is left to the individual services.¹⁰⁶

The Army Procurement Procedure prescribes a single facilities contract¹⁰⁷ which in one section binds the contractor to acquire certain facilities set forth in an attached schedule, and in another section requires the Government to furnish certain facilities listed in another schedule. As these sections are written so as to be self-deleting if not applicable, the contract may still be used even if both kinds of facilities are not involved.

The Navy Procurement Directives do not prescribe any special form of facilities contract, but the Navy, in accordance with its needs, has developed two kinds of contracts to deal with facilities. One is a facilities procurement contract, which is a cost-no-fee contract whereunder the contractor is bound to acquire certain facilities for which he is reim-

105. Armed Services Procurement Reg. 13-405, 32 C.F.R. § 13.405 (1961).

106. An Armed Services Procurement Regulation facilities contract, uniform for all services, has been under development for several years and will soon be published.

107. Army Procurement Procedure 16-556, 32 C.F.R. § 605.556 (1962).

bursed under the contract. The other is a facilities management contract which covers all of the rights and duties of the contractor and the Government respecting the facilities in the contractor's possession, but which provides neither for the furnishing of facilities to the contractor nor for his acquiring any.

The Air Force, which has far more activity in the facilities field than either of the other services, prescribes two kinds of facilities contract in its Procurement Instructions: a long-form contract, and a short-form contract.¹⁰⁸ The long-form contract is designed to cover situations both where facilities are furnished to a contractor and where he is bound to acquire them, and is used in situations where it is anticipated that eventually, if not at the signing of the contract, both kinds of property will be in the contractor's possession. The short-form contract covers only situations where the Government furnishes facilities.

The Defense Supply Agency does not have a prescribed form of facilities contract.

Regardless of the form which the separate-facilities contract takes, it must make certain provisions in addition to the one on title already referred to.

For one thing, the Armed Services Procurement Regulations require that each facilities contract limit the contractor's right to use the facilities to the performance of contracts identified in the facilities contract.¹⁰⁹ Furthermore, if the facilities contract authorizes the use of the facilities in advertised contracts, the facilities contract must specify a rental to be paid.¹¹⁰

Where facilities are to be provided a contractor for his use in performing negotiated contracts, they are usually provided at no charge. The typical situation is one where a contractor is in possession of government facilities under a facilities contract which provides generally for no-charge use. The procurement contracts which the contractor gets from time to time tie into the facilities contract by stating that in performing them the contractor may use, at no charge, the facilities which he has under his facilities contract.¹¹¹

This situation does not mean that the contractor is permitted a windfall. The Government is providing the contractor with facilities which he would otherwise have to provide for himself. It is easy to see that in

108. Clauses for the long-form contract are found in Air Force Procurement Instruction 7, pt. 27, 32 C.F.R. pt. 1007, subpart AA (1963), and for the short-form contract in the same section at pt. 28, 32 C.F.R. pt. 1007, subpart BB (1963).

109. Armed Services Procurement Reg. 13-407, 32 C.F.R. § 13.407 (1961), as amended, 32 C.F.R. § 13.407 (Supp. 1963).

110. *Ibid.*

111. See, e.g., Air Force Procurement Instruction 7-4052, 32 C.F.R. § 1007.4052 (1963).

such a circumstance the Government must receive adequate consideration, either through reduced prices for the supplies or the services being procured, or otherwise.¹¹²

But the Government's interest extends beyond being assured that it receives consideration for providing the contractor, at no charge, with what he would otherwise have to provide as part of his capital equipment. It is fundamental to all government procurement that no would-be government contractor may be favored over another, and for this reason it is well-known government policy that "all procurements, whether by formal advertising or by negotiation, shall be made on a competitive basis to the maximum practicable extent."¹¹³ So where no-charge use of facilities is being considered, the government contracting officer is required not only to obtain some adequate consideration but also to assure that authorizing such use will not place the contractor in a favored competitive position.¹¹⁴ In short, the contracting officer must do what he can to see to it that the fact that a contractor is in possession of government facilities under a facilities contract does not mean that he thereby gains an unfair advantage, either over the Government or over another would-be contractor.

The extent of the contractor's right to use the facilities, and the charges which he must pay in the event he is using them in connection with work for which rent-free use is not authorized, are set forth in a separate clause of the facilities contract.¹¹⁵ It is important to note that provided certain approvals are obtained, the contractor may make incidental use of the facilities in his possession for other than Defense Department work, including commercial work, but in this latter instance, of course, he is required to pay rent.¹¹⁶

As might be expected, facilities contracts deal with the matter of responsibility for maintenance of the facilities provided. The Armed Services Procurement Regulations state that each facilities contract shall require the contractor, without cost to the Government, to protect, preserve, maintain and repair the facilities provided, in accordance with

112. *Ibid.* And, of course, before the government contracting officer may agree to furnish the facilities, it must be clear to him that doing so is consistent with the policy considerations previously discussed.

113. Armed Services Procurement Reg. 1-300.1, 32 C.F.R. § 1.300-1 (1961).

114. Armed Services Procurement Reg. 13-407, 32 C.F.R. § 13.407 (1961), as amended, 32 C.F.R. § 13.407 (Supp. 1963).

115. See, e.g., Air Force Procurement Instruction 7-2703.12, 32 C.F.R. § 1007.2703-12 (1963). Rental rates, although referred to in a use-and-charges clause, are usually set out in a separate exhibit to the contract. Contractors are authorized to use the facilities on sub-contracts as well as prime contracts.

116. Armed Services Procurement Reg. 13-407(c), 32 C.F.R. § 13.407(c) (1961), as amended, 32 C.F.R. § 13.407(c) (Supp. 1963).

sound industrial practice.¹¹⁷ The contract, however, may and often does provide for the Government to reimburse the contractor for repairs, replacements and restoration which are in excess of normal maintenance.¹¹⁸

The question of what constitutes normal maintenance, and what may properly be considered abnormal, or in excess of normal maintenance, is not always easily answered, and has been the subject of litigation.

For example, in one case¹¹⁹ where the facilities contract required the contractor to maintain the facilities at no expense to the Government in accordance with sound industrial practice, but also provided for the Government to reimburse the contractor for the reasonable cost of repairs and replacements in excess of normal requirements for maintenance or in excess of fair wear and tear, the contractor had acquired an electric hardening furnace at a cost of over \$16,000. A year later, due to a temporary discontinuance of power by the public utilities company which serviced the contractor, the furnace had to be shut down. When the cooled furnace was inspected the following day, its inner dome was partially collapsed and had to be replaced along with part of the outside dome.

The evidence showed that inner domes of such furnaces were considered wearing parts which required periodic replacement during their life, in the same manner as any wearing part of a machine would. Consequently, the Board of Contract Appeals found that the damage could not be considered in excess of fair wear and tear, and that the contractor was responsible for the cost of the repairs, notwithstanding such cost amounted to almost \$8,000—just less than half the cost of the entire furnace.

In another case¹²⁰ the Government undertook to pay for the costs of the "abnormal maintenance" of two 50,000 pound steam drop forge hammers. Some time after the hammers had been installed, it was noted that they were tilting, and in order to correct this condition the hammers had to be dismantled and the foundations repaired.

The Board found that although the needed repair work on the foundations clearly fell within the meaning of the term "abnormal maintenance," this repair work was to the foundations and not to the hammers. As it was clear from the contract that the Government's obligation ran only to abnormal maintenance of the hammers, the contractor could not be reimbursed.

117. Armed Services Procurement Reg. 13-408, 32 C.F.R. § 13.408 (1961).

118. *Ibid.*

119. Rheem Mfg. Co., A.S.B.C.A. 3445, 56-2 B.C.A. ¶ 1145 (1956), appeal dismissed, *Rheem Mfg. Co. v. United States*, — Ct. Cl. — (1961).

120. Kropp Forge Co., A.S.B.C.A. 5049, 59-2 B.C.A. ¶ 2279 (1959).

The Armed Services Procurement Regulations provide that facilities contracts shall contain no warranty, express or implied, regarding the fitness for use of any item or industrial facilities furnished by the Government.¹²¹ It is, of course, easy to exclude an express warranty from a facilities contract, but excluding an implied one is a different matter. A warranty may be implied simply from the arrangement of the parties itself, whether the Government desires it or not. In one case¹²² where there was neither an express warranty nor a disclaimer of warranty in either the facilities or related supply contract, the Court of Claims held that the Government had impliedly warranted the fitness of machines which it had furnished the contractor. The holding was based upon the proposition that a mutual benefit bailment existed between the Government and the contractor, and this being so, there was imposed upon the bailor an obligation that the "property bailed for use shall be reasonably fit for the purposes, or capable of the use known or intended."¹²³

The Air Force has sought to insure against the arising of any warranty by providing in its facilities contracts that "the Government makes no warranty, express or implied, as to the serviceability or fitness for use of the facilities so furnished,"¹²⁴ but the other services do not seem to have dealt with this matter.¹²⁵

The matter of liability for loss or damage to industrial facilities contracts, and the scope of the risk undertaken by each party, are substantially similar to those set out in the government property clause of an ordinary cost contract.¹²⁶ The contractor is not liable for loss or damage except that which results from either: (1) a risk which is required to be insured against, (2) a risk which in fact is insured against, or (3) a risk which results from willful misconduct or lack of good faith on the part of the contractor's directors, officers or managers.

The Government has the right under a facilities contract to divert the delivery of any of the facilities to locations other than those specified in the contract, and in such a case, or if the Government fails to deliver

121. Armed Services Procurement Reg. 13-408, 32 C.F.R. § 13.408 (1961).

122. *Ekco Prods. Co. v. United States*, — Ct. Cl. —, 312 F.2d 768 (1963).

123. *Id.* at —, 312 F.2d at 771.

124. Air Force Procurement Instructions 7-2703.2, -2803.2, 32 C.F.R. §§ 1007.2703-2, 2803-2 (1963).

125. See Army Procurement Procedure 16-556, 32 C.F.R. § 605.556 (1962). As noted previously, neither the Navy nor the Defense Supply Agency prescribe a form of facilities contract in their directives implementing the Armed Services Procurement Regulations.

126. Armed Services Procurement Reg. 13-441, 32 C.F.R. § 13.441 (1961), as amended, 32 C.F.R. § 13.441 (Supp. 1963). A facilities contract is, of course, a cost contract, the contractor being paid neither a profit nor a fee for the facilities which he acquires on the Government's behalf.

any of the facilities, or delivers them late, an equitable adjustment may be made.¹²⁷ The policy here is the same as that which obtains under the government-furnished property clause: if the Government fails to furnish government property as required by the contract, the contractor may not receive damages for breach of contract, but he is entitled to an equitable adjustment in respect of those matters affected by the Government's failure to perform.

The provisions for an equitable adjustment in the case of failure are not contained in the facilities contract itself, but do appear in the related supply or services contracts which the contractor has with the Government.¹²⁸

Facilities contracts provide for the orderly disposition of the facilities if they become surplus to the contractor's needs, or if the contract is terminated,¹²⁹ and also require the contractor to maintain property control records in accordance with the same standards that govern a contractor in possession of government-furnished property under the government-furnished property clause.¹³⁰

Before leaving facilities contracts, the matter of so-called "nonseverable industrial facilities" should be considered. This term refers to facilities which cannot be removed from the premises to which they are attached without a substantial monetary loss being involved,¹³¹ and the rules regarding such facilities operate where the nonseverables are located on land not owned by the Government.

Situations sometimes arise where, from the point of view of accomplishing certain government procurements, it seems desirable to locate nonseverables on land owned by a contractor or occupied by him and owned by a third party. The Air Force has stated its policy regarding this matter:

Since the locating of Government-owned nonseverable industrial facilities on land not owned or controlled by the Government may result in unjust enrichment of the land owner or an unnecessary loss to the Government, every effort must be made to have such nonseverable facilities provided by the contractor. If the contractor refuses to provide such nonseverable facilities, it is necessary to evaluate all other alternatives before locating Government-owned nonseverable industrial

127. Armed Services Procurement Reg. 13-410, 32 C.F.R. § 13.410 (1961).

128. Armed Services Procurement Reg. 13-410, 32 C.F.R. § 13.410 (1961). See, e.g., Air Force Procurement Instruction 13-401, 32 C.F.R. § 1013.401 (1963).

129. Armed Services Procurement Regs. 13-412 to -415, 32 C.F.R. §§ 13.412 to .415 (1961).

130. Armed Services Procurement Reg. 13-409, 32 C.F.R. § 13.409 (1961).

131. Air Force Procurement Instruction 13-406, 32 C.F.R. § 1013.406 (1963), states that "a facility will be considered 'non-severable' when loss of value to it plus damage to the premises where installed, may, upon removal, reasonably be anticipated to exceed 50 percent of the installed cost of the facility item."

facilities on land not owned or controlled by the Government. Such alternatives include the possibility of the Government's acquiring land for the purpose, or accomplishing the work by subcontracting.¹³²

The Department of Defense, although not as restrictive in its regulation as the Air Force is in its implementing regulation just quoted, does prohibit the installation of nonseverable facilities on other than government land unless certain conditions are met.¹³³ These conditions, of course, are binding on all three services.

The first condition is that the head of one of the procuring activities for the armed service concerned or for the Defense Supply Agency must determine that locating the nonseverables on other than government land is necessary.

In addition to this, either: (1) the contract under which the facilities are provided must contain a provision for reimbursement to the Government for the fair value of the facilities at the completion or termination of the contract, or (2) the United States must have an option to acquire the underlying land, or (3) the secretary of the department concerned must determine that the contract contains a provision which protects the interests of the Government in the facilities.¹³⁴

Although these three Defense Department requirements apply to all kinds of nonseverable industrial facilities located on other than government land, regardless of the kind of work the facilities are being used for, the same three requirements are also statutory in respect of research and development nonseverables.¹³⁵

When nonseverables are located on other than government land, the Government is given the right to abandon them under the Armed Services Procurement Regulations, and it may do so without any obligation to rehabilitate the premises, unless the contract provides otherwise.¹³⁶

VIII. FACILITIES LEASES

As mentioned earlier, there is federal legislation which permits the secretaries of the military departments to lease real or personal property upon such terms as they consider will promote the national defense or be in the public interest.¹³⁷

132. Air Force Procurement Instruction 13-406, 32 C.F.R. § 1013.406 (1963).

133. Armed Services Procurement Reg. 13-406, 32 C.F.R. § 13.406 (1961), as amended, 32 C.F.R. § 13.406 (Supp. 1963). See Army Procurement Procedure 13-406, 32 C.F.R. § 602.406 (1962), and Navy Procurement Directive 13-451 (1959), for the Army and Navy implementation of the Armed Services Procurement Regulations.

134. *Ibid.*

135. 10 U.S.C. § 2353 (1958).

136. Armed Services Procurement Reg. 13-416, 32 C.F.R. § 13.416 (Supp. 1963).

137. 10 U.S.C. § 2667 (1958).

The property to be leased must, of course, be under the control of the military department concerned, and it must not be needed at the time for public use.¹³⁸ On the other hand, the property must not have been declared "excess," *i.e.*, not required at all by the department for its needs and the discharge of its responsibilities.¹³⁹

The term of the lease is limited to five years, and it must be revocable by the secretary at any time, although the term may be extended and the revocation provision omitted if the secretary concerned determines that doing so will promote the national defense or be in the public interest. In any event, the lease must be revocable by the secretary during a national emergency.¹⁴⁰

The Armed Services Procurement Regulations contemplate that industrial facilities provided a contractor for use on defense work will generally be covered by a facilities contract, not a lease. Hence the Defense Department's implementation of the legislation just discussed relates to leases of government-owned industrial facilities primarily for nondefense use.

The implementation is not extensive, and is concerned mainly with rules governing rental policies and rates.¹⁴¹ The regulations state, *inter alia*, that the rental shall "be such as to prevent the user from obtaining an unfair competitive advantage by reason thereof over competitors who own their facilities or obtain them from private sources."¹⁴² This expression of the Government's interest in not hampering competition by its procurement and related procedures is similar to that seen in connection with the no-charge use of facilities.

The rates charged for the rental of equipment depend upon the age of the equipment, and are expressed in terms of a percentage of the acquisition cost. Real estate rates are required simply to be fair and reason-

138. *Ibid.*

139. 63 Stat. 378 (1949), 40 U.S.C. § 472(e) (1958).

140. 10 U.S.C. § 2667 (1958). The right to revoke during a national emergency was written into the Navy lease of an airfield, which in its preamble stated that the property was being leased rather than sold because it was needed in a stand-by status for naval activities. The Supreme Court held that the Government was not restricted in these circumstances to a revocation for aviation purposes, but could properly revoke so that the Army could use the field for a missile site. *United States v. 93,970 Acres of Land*, 360 U.S. 328 (1959). The statute also provides (1) that the lease may give the lessee the first right to buy the property if it is revoked in order to allow the United States to sell the property, and (2) that the lease may provide for maintenance, protection, repair or restoration by the lessee to constitute all or part of the consideration for the lease.

141. Armed Services Procurement Reg. 13, pt. 6, 32 C.F.R. pt. 13, subpart F (1961), as amended, 32 C.F.R. pt. 13, subpart F (Supp. 1963).

142. Armed Services Procurement Reg. 13-601.1, 32 C.F.R. § 13.601 (1961), as amended, 32 C.F.R. § 13.601 (Supp. 1963).

able.¹⁴³ No special form of facilities lease is prescribed in the regulations.

Under the same legislative authority being discussed, the Air Force has made special provision for leasing machine tools and other items of production equipment for defense purposes.¹⁴⁴ Before such a lease may be entered into, a determination must be made that the use of a facilities contract is for some reason impracticable or inappropriate in the particular case.¹⁴⁵ Defense-purposes leases must follow a prescribed form.¹⁴⁶

IX. OTHER CONTRACTUAL ARRANGEMENTS

Before concluding, there is one other type of contractual arrangement described in both the Army and Defense Supply Agency regulations, and another described in the Air Force regulations, which should be mentioned. Neither of these arrangements is covered in the Defense Department's Armed Services Procurement Regulations.

The Army regulations (and the Defense Supply Agency's in identical language) provide that:

Government property acquired for research and development may be loaned to private industrial firms and educational institutions for use in privately financed research and development programs, if such programs are of interest to the Government and the results of the research will be furnished the Government without cost to the Government.¹⁴⁷

Although no form covering such a contemplated transaction is set forth in the regulation, it does state that "any such loan should be reflected in a written agreement setting forth the terms of the loan, and the benefits to be derived by the Government."¹⁴⁸

The Air Force Procurement Instructions provide that government property may be made available to contractors for a specific purpose connected with a procurement contract under a bailment agreement.¹⁴⁹ This agreement is separate from but related to the procurement contract in much the same way as a facilities contract is, and covers substantially the same ground.

The Air Force desires bailment agreements to be kept to a minimum, and they are not entered into unless: (1) they are necessary in the interest of national defense, (2) they will not adversely affect competition, and

143. Armed Services Procurement Reg. 13-601.2, 32 C.F.R. § 13.601-2 (1961).

144. Air Force Procurement Instruction 13, pt. 30, 32 C.F.R. pt. 13, subpart DD (1963).

145. Air Force Procurement Instruction 13-3001, 32 C.F.R. § 1013.3001 (1963).

146. Air Force Procurement Instruction 13-3004, 32 C.F.R. § 1013.3004 (1963). The form is set out in Air Force Procurement Instruction 7, pt. 29, 32 C.F.R. pt. 7, subpart CC (1963).

147. Defense Supply Procurement Reg. 13-1601 (1962); see Army Procurement Procedure 13-1601, 32 C.F.R. § 602.1601 (1962).

148. *Ibid.*

149. Air Force Procurement Instruction 13-102.50, 32 C.F.R. § 1013.102-50 (1963).

(3) the property bailed is not available to the contractor in the open market.¹⁵⁰ There are, however, hundreds of Air Force bailment agreements signed each year, and the Air Force Procurement Instructions deal with them in some detail.¹⁵¹

Aircraft and electronic equipment are the items most frequently bailed, and under the agreement the bailee's obligations regarding maintenance and use of the property are far more specific than they are under either the government-furnished property clause or under a facilities contract.

X. CONCLUSION

The Department of Defense, and under it the military services and the Defense Supply Agency, have developed an elaborate structure of contractual arrangements for making government property available to defense contractors. These arrangements are, for the most part, mandatory in the situations to which they apply. Whether embodied in a procurement contract or in a separate instrument, they are, properly considered, part of the basic agreement under which a contractor supplies the Government with hardware or services. They merely set forth the rights, duties and consequences which flow when the Government, in order to facilitate procurement, places its property in the hands of that contractor.

It seems fair to state that, given the Defense Department's need for billions of dollars worth of complex hardware, its interest in preserving our competitive system, and its duty to effectively use and protect its material resources, the contractual arrangements covering the use of government property by defense contractors are practical, equitable, and legally well conceived.

150. *Ibid.*

151. See Air Force Procurement Instructions 13-102.50, -102.51, 32 C.F.R. §§ 1013.102-50, .102-51 (1963).