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The Clause

The President's Column

by
Judge Richard Walters
CBCA

Our year began with a bang. The Trial Practice Seminar, "***Effective and Ethical Practice At the Boards of Contract Appeals,***" which we again sponsored jointly with the George Washington University Law School, was held at the GW Law Moot Court Room on October 25, 2006, and was among the very best seminars our Association has ever conducted. BCABA's Vice President/President Elect, Mike Littlejohn, chaired the seminar for the second straight year, and managed to field a truly superb panel of BCA Judges (Judge Alexander Younger of Armed Services Board of Contract Appeals and Judge Robert Parker, Vice-Chairman of General Services Board of Contract Appeals), and highly experienced practitioners, both from Government (Thomas H. Gourlay, Chief Trial Attorney of the United States Army Corps of Engineers, and BCABA Treasurer) and the private sector (Stephen B. Hurlbut, Shareholder, Akerman Senterfitt Wickwire Gavin). An excellent set of materials was also provided (see **BCABA Website** below), as well as some very helpful CLE credit (*This year's program was approved by the Virginia Mandatory Continuing Legal Education Board for 1.5 hours of CLE credit (including 0.5 hours of ethics credit)*), plus a fine basket lunch, **and all at no charge!**

Planning for the remaining programs this year is well under-way. Here are some details.

Spring Colloquium

The BCABA calendar again will include a BCABA/GW Colloquium at GW Law in early Spring 2007. The program, entitled ***"Alternative Dispute Resolution in Government Procurement: New Horizons,"*** will feature a panel of judges and experts in all forms of alternative dispute resolution (ADR) who will address the latest initiatives and trends in the use of ADR for resolving Government contract disputes. The Colloquium is scheduled for **Thursday, April 19, 2007, from 9:30 to 11:00 A.M.** at the GW Law School Moot Court Room. Please mark your calendars, and plan to join us.

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In Memoriam

Judge Bernard V. Parrette, Vice Chairman of the Interior Board of Contract Appeals, died in his sleep on November 5, 2006. He joined the IBCA in 1986 after a very interesting legal career, from service in the Air Force Judge Advocate General Corps and in the Air Force Reserves, to work as a lawyer at HUD, Commerce, the Federal Railroad Administration of the Department of Transportation, and as a Judge and Chief Judge of the Land and Indian Appeals Boards at Interior.

Life will be a little tamer without Bernie, because he was never afraid to let it be known what he thought, and what he thought was not always in the mainstream. He particularly enjoyed the Indian Self-Determination Act cases at the IBCA, since the crux of the cases was the Indian Tribes' ability to govern themselves and provide for their own needs. One of his decisions, finding that the government had inappropriately withheld funds from the Cherokee Nation, was upheld by the Court of Appeals for the Federal Circuit, and ultimately by a unanimous U.S. Supreme Court. Life will also be a little less colorful, with out Bernie's bolo ties!

Counsel for the Cherokee Nation, Lloyd Miller of Sonosky, Chambers, Sachse Miller and Munson, eloquently summed up Judge Parrette's contributions: "Judge Parrette had a special place in his heart for the West, and in his work, he had a special place in his heart for Indian Tribes, whose contractual relations with the Government were among the most complex. While Judge Parrette always 'called them like he saw them,' he seemed never to forget that every case involving a Tribe and the Government arose within a much deeper context of centuries of abuse, followed by the new rising spirit of Tribal self-governance that has now been the hallmark of Tribal life for many decades. As one of many advocates before him for Indian tribes, we always knew that while we might not win every case, Judge Parrette's gruff manner in the hearing room was always going to be tempered by his appreciation for the realities of life on the reservations, and the history of Federal-Tribal relations."

The Judges on the new CBCA will miss his counsel and his company, but will have his many fine decisions to ponder as they adjudicate new disputes between the Government and the Indian tribes.

Candida Steel
Administrative Judge
Civilian Board of Contract Appeals

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Acknowledgement
MAJ Rebecca Vernon, JA

The BCABA wishes to extend its gratitude to MAJ Rebecca Vernon, USAF, for her years of unselfishly reformatting and continually improving the quality of *The Clause.* Her work was not only greatly appreciated by the BCABA officers she worked with, but by the BCABA membership as well, many of whom expressed their compliments on the improved and more professional appearance of *The Clause*. This article is an acknowledgement that the current stature of *The Clause* in the government contract bar is largely due to her hard work and efforts. While her Air Force commitments always came first, MAJ Vernon never failed to help with *The Clause,* and she worked tirelessly on her own time to get each issue out as quickly as possible.

It has been a pleasure for the BCABA to be associated with MAJ Vernon. We wish her every professional success and sincerely hope that her path will cross ours again.

President's Column (cont'd):

Annual BCA Judges' Reception

BCABA also co-sponsors a Judges Reception each year, along with the D.C. Bar and Federal Bar Association, and that always proves to be a special program. This year's Reception has been scheduled for **Wednesday, May 16, 2007,** and again will be held at the offices of Gibson, Dunn here in Washington. Again, please mark your calendars and plan to attend. Further details will be provided as the program date approaches.

Executive Policy Forum

In July 2007, BCABA will have its Executive Policy Forum, a program open to our Gold Member Firm and Government agency lawyers. This year's Forum, ***"New Directions -- Enhancing the Role of the Boards in Dispute Resolution,"*** will address, among other topics:

* Technology and Electronic Filing
* Lack of uniformity of rules between ASBCA and the CBCA
* Other ASBCA and CBCA Differences

2007 Annual Program

Although a date and location have yet to be set for our Annual Program (which is held every Fall), this year's Program Chair (and our Vice President/President Elect) Mike Littlejohn has already organized a Program Task Force for the event, and planning will be underway in the very near future. Stay tuned for details.

The Clause

The Clause, BCABA's on-line publication, keeps getting better with each issue. Pete McDonald, the Editor, advises that, because we publish it online, there are no limitations on article length or numbers of articles. The quality of our articles has been consistently good and, because of its widespread distribution, contributing an article for publication in ***The Clause*** is worthy of your serious consideration. Pete would also appreciate hearing from anyone who would like to assist in editing ***The Clause.*** Pete can be reached at pete.mcdonald@rsmi.com.

The current (January 2007) edition of ***The Clause*** has been dedicated to the memory of our friend and longtime colleague, Judge Bernard V. Parette, the Vice Chairman of the Department of Interior Board of Contract Appeals (IBCA) who passed away recently. Judge Candida Steel, former Chairman and Chief Administrative Judge of the IBCA and now among the fine Administrative Judges at the Civilian Board of Contract Appeals (CBCA), has provided an interesting look at Bernie's extensive career in Government contracts and, in particular, his work with Indian Self-Determination Act cases. We will certainly miss Bernie.

The BCABA Website

Please monitor the BCABA Website (http://www.bcaba.org) for information on all our future BCABA programs.

Our "user friendly" website has been further upgraded. Our **Members-Only Page** not only contains the online BCABA Directory, with the mailing and e-mail addresses and telephone and fax numbers for all of our members, but now holds all of our **archived issues** of ***The Clause,*** and a number of other helpful **resource links and documents**, including program materials from our recent Trial Practice Seminar.

(*continued on next page*)

President's Column (cont'd):

Membership in BCABA clearly has many advantages – and the price of membership is still remarkably low ($45 for private sector members; $30 for Government members).

Quarterly Meetings

I invite you to join us at the remaining quarterly meetings of our BCABA Board of Governors, which are scheduled to be held at the offices of Holland & Knight LLP, 2099 Pennsylvania Avenue, N.W., Washington, D.C., on the following dates (all Thursdays): March 22, 2007; June 21, 2007; and September 20, 2007. Reservations are needed, so that we may make adequate arrangements for the numbers who will attend.

To be sure, the BCABA plate is full this year. As I've said before, I invite you all not only to participate in these stimulating activities but to become more involved in their planning. Your ideas and your help are most welcome. Feel free to get in touch with me or with any of our officers. My new e-mail address at the new Civilian Board of Contract Appeals is Richard.Walters@gsa.gov.

All the best to you and your families for a Happy, Healthy New Year!

Hon. Richard C. Walters
President

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Bored of Contract Appeals
(a.k.a. The Editor's Column)
by
Peter A. McDonald
C.P.A., Esq.
(A nice guy . . . basically.)

In this issue, we have an article on government contract administration by Rich Lieberman that provides much good advice to small business clients. Mark Hanson's article, "Aspects of Construction Scheduling," provides enlightenment on the important nuances of schedules in construction contracts, and Dan Cantu reminds us of issues related to organizational conflicts of interest. Mike Littlejohn's article comprehensively covers the little-known Defense Priorities and Allocation System (DPAS), while Stu Nibley thoughtfully discusses the conflicting messages government procurement personnel receive when trying to decide on the government's best interests. And if you can stand the pain, there is also an article on material overhead that is thankfully brief.

The Clause is not copyrighted and does not have a publication limitation. We welcome articles on topics of interest to government contract practitioners, but remember people: Don't take all this government contract stuff too seriously. In that regard, we received some articles that were not suitable for publication, such as: "Pete McDonald: the Parties; the Drinking; the Lies!"; "Rumor of Prominent D.C. Attorney Talking to Another Firm *is Admitted!*"; and "BCA Judge Sustains Objection Made *by Co-counsel!*"

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Ten Big Mistakes in Government Contract Administration
by
Richard Lieberman*

[Reprinted with permission from the National Contract Management Association, *Contract Management*, December 2006.]

In my 38 years of working in and around government contracting, including 18 years as government contracts counsel and advising clients, I find it surprising that government contractors repeat certain classic mistakes so frequently. This is particularly true of new government contractors. Information on these mistakes is readily available from training courses, literature, case law, and from others in the field. Presented herein are my views of ten common mistakes made by contractors in the administration of government contracts.

1. Have you ever actually read your entire contract?

The written contract is the key to your obligations and responsibilities. How many contractors actually read the entire contract before beginning performance? Most read the Statement of Work (SOW) and proceed from there, but there are other critical sections in the uniform contract format that may be equally important, such as Section E, Inspection and Acceptance; Section F, Deliveries or Performance; Section G, Contract Administration Data; and Section H, Special Contract Requirements.

Indeed, many vital clauses are not even printed in your contract. Almost every government contract includes a clause that permits the government to "incorporate clauses by reference." Essentially, the government lists the *Federal Acquisition Regulation* (FAR) clauses, and states, "[t]his contract incorporates one or more clauses by reference, with the same force and effect as if they were given in full text." You can easily obtain the full text on the Internet or you can ask your contracting officer for a copy. It doesn't matter whether the clauses are printed in your contract in full text or incorporated by reference — you are still responsible for all duties and obligations contained in them. Indeed, the typical government contract, which might be only 30 pages long, expands to two or three times that length once the clauses incorporated by reference are printed out. The smart contractor prints out a copy of all clauses incorporated by reference, and inserts it into the master contract file before the contract starts.

There is no substitute for a detailed, in-depth reading of your contract before performance begins. If you know the duties and obligations stated in any clause incorporated by reference, you can make a mental note and skip to the next. If you don't know the duties and obligations, you must read the full text of that clause.

With certain minor exceptions that are not worth discussing here, the general rule is that the *FAR* clause in effect at the time of the execution of the contract (and presumably included in your solicitation and contract) applies to that contract. It does not matter if the FAR clause is changed and updated one or more times during the performance of your contract — the clause in your contract at the time of award governs your rights and obligations. The government may not change these clauses without your agreement, or without permitting you to make an equitable adjustment resulting from the change.

2. Is your performance world-class and do you care about your customer?

In today's government contracting environment, "satisfactory" performance will not ensure both current and future success. To grow as a business, the performance of a government contractor must be "world-class" and must demonstrate that the contractor shares the concerns of his agency client. Only then will you achieve the kind of respect and admiration that will make the agency want to award more contracts to you. Here are some suggestions that may help you a world-class contractor, but remember, all of them must be done within the framework of your contract's statement of work and specifications.

Provide effective and efficient solutions to your customer's problems;

(*continued on the next page*)

Be innovative when problems arise;

Recommend improvements and efficiencies for contract processes and procedures; for example, recommend appropriate value engineering change proposals, i.e., suggestions made by the contractor for performing the contract more economically;

Provide superior service to your government customer; and

Provide a skilled, well-trained, capable, and professional contract workforce.

3. Do you take directions from unauthorized officials?

Government contract cases at the Court of Federal Claims and the Boards of Contract Appeals are filled with examples of contractors who took direction from officials who had no authority to direct them. The *FAR* states

> Contracting officers have authority to enter into, administer, or terminate contracts, and make related determinations and findings. [They] may bind the government only to the extent of the authority delegated to them [and they] shall receive from the appointing authority (citation omitted) clear instructions in writing regarding the limits of their authority. Information on the limits of the contracting officers' authority shall be readily available to the public and agency personnel.

Although not clearly stated in the FAR, government personnel and contractors often speak of these officials as "warranted contracting officers." Contract specialists (who work for the contracting officers) do not posses this authority, nor does a contracting officer's representative, a contracting officer's technical representative (COTR) , or any other inspector, auditor, or similar person working for the contracting officer. Only the contracting officer (CO) can give you direction, interpret the specifications, demand changes, or revise the written contract in any way.

The changes clause of most contracts states, "the contracting officer may, at any time, by written order. . .make changes within the general scope of this contract. . ." When speaking of the contracting officer, the *FAR* defines this person as someone

> With the authority to enter into, administer, and/or terminate contracts, and make related determinations and findings. The term includes certain authorized representatives of the contracting officer acting with the limits of their authority as delegated by the contracting officer. 'Administrative Contracting Officer' (ACO) refers to the contracting officer who is administering contracts.

Contractors forever confuse the contracting officer, who has these authorities, with the ACO, who normally does not posses them. Indeed, the most common CO/ACO split occurs in the Department of Defense (DOD), where buying activities employ the COs (who possess this authority), but the contracts are administered by the Defense Contract Management Agency (DCMA), a group of ACOs who lack the authority. Many times the CO and ACO are located at separate geographic locations. Although a CO may delegate his or her authority to an ACO, it is rare.

It is easy to find out if a person (such as an ACO, COR, COTR, or inspector) who attempts to direct you or make a change in your contract has the authority to do so — just ask this person for his or her written delegation of authority. If it isn't in writing from a contracting officer (or his designee), it isn't valid direction under the FAR. If an ACO, COR, COTR is reluctant to give you a copy of his or her delegation, you should conclude that he or she she possesses no such authority and contact your CO. The case law is filled with contractors who took direction from someone without authority and the result is always the same — the court or board finds against the contractor or denies the claim because the contractor did not comply with the written contract.

4. Do you always comply with quality control or quality assurance requirements and specifications in your contract?

Quality is a crucial aspect of any contract. Contract quality requirements are the "technical requirements in the contract relating to the quality of the product or service and the clauses prescribing inspection and other quality controls incumbent on the contractor to assure that the end product or service conforms to the contract requirements." Basically, there are four different quality requirements.

Commercial items that rely on the contractor's existing quality assurance systems as a substitute for government inspection;

Government reliance on inspection by the contractor for contracts less than $100,000;

Standard inspection requirements that require the contractor to maintain an acceptable inspection system (including records), and also give the government the right to test and make inspections while work is in progress; and

Higher-level contract quality standards for complex or critical items (high-performance aircraft, submarines, etc.).

The government is entitled to insist upon strict compliance with the contract specifications and to require correction of nonconforming work. It is imperative that a contractor develop a quality assurance or quality control inspection system that rejects nonconforming items and tenders only those goods or services that meet the contract. The government deems such quality systems essential for all contractors, and even if you must engage a consultant to develop your system, the cost will be well worth it. Failure to do so could result in rejection of your goods as nonconforming.

5. Do you always follow what is in your written contract, or do you listen to verbal promises and direction?

Only the written word is binding. Contractors should learn to ignore diplomatically any verbal advice from any government official — no matter how convincing. The written contract always defines your duties and responsibilities. Reliance on verbal advice from unauthorized government employees is at the contractor's risk and the government is not bound by such advice. This is particularly true when a government official attempts to make a "side deal" (e.g., "Instead of fixing the faucets in Building 520, as required by the contract, just fix the toilets in the commander's house. We will call it a wash.") These verbal requests are usually made by government officials who do not have legal authority to change the contract (i.e., are not warranted contracting officers), and may have their own agenda. In these circumstances, you must respond diplomatically, but otherwise ignore such requests.

6. Do you fail to deliver on time as required by the delivery schedule and think the government will deem this to be acceptable?

Failure to meet the delivery schedule is a very common reason for the government to terminate your contract for default immediately. Do not think you can be late an get away with it. Default can be prevented only by a good reason or cause that was beyond the contractor's control and without its fault or negligence. The fixed-price default clause states that the government may terminate a contract in whole or in part if the contractor fails to deliver the supplies or to perform the services within the time specified in the contract. No "cure notice" — a letter of noncompliance requesting that the contractor make corrections — is required. The government may also terminate the contract after sending a cure notice if the contractor fails to make progress, so as to endanger performance, or fails to perform any other provision of the contract and the condition is not cured within 10 days.

It is very important to perform all of the required aspects of your contract, including on-time delivery. The consequences of a default termination are severe, and the courts call it a "drastic sanction."
(*continued on next page*)

Not only does a default cause you to lose your current contract, but it has two other severe consequences.

The government may acquire supplies or services similar to those terminated, and the contractor will be liable to the government for any excess costs for those supplies or services (i.e., costs in excess of the price of the terminated contract) — this could be substantial and could easily bankrupt a small business; and

The default may come back to haunt you by causing the loss of future contracts. All government contracts over $100,000 are required to include a certification by the contractor stating whether they have or have not "within a three-year period preceding [the contract] had one or more contracts terminated for default by any federal agency."

There is no way to hide your default and you can rest assured that the next contracting officer is likely to think twice about awarding you a new contract if you have a recent default.

7. **Do you invoice properly, in accordance with the requirements of your contract?**

Cash flow is the lifeblood of any business, including government contracting. Every contractor needs cash to operate, purchase supplies, pay rent, hire employees, and take care of many other business activities. Surprisingly, many government contractors are somewhat cavalier about cash flow. Having received a contract, they fail to follow up on the receipt of payments from the government, which is a notoriously slow payer despite the Prompt Payment Act, which requires payment within 30 days of a proper invoice. Improper invoicing can hurt a government contractor in two ways: (1) if the contractor doesn't invoice properly, the invoice may not get paid; and (2) an overzealous or cheating contractor may falsify its invoices, which is likely to result in civil and criminal fraud prosecution, something that no government contractor wants.

What are the solutions to these two problems? For the first one, the key is to develop a system that does the following:

- Ensure that every invoice is "proper," that it fully complies with all contractual requirements, and is sent to the correct address stated in the contract.

- If you do not receive payment within 45 days, write to the contracting officer and insist that the invoice be paid within seven days (or if it was not a proper invoice, correct and resubmit it).

- If you do not get paid within seven days, obtain counsel and submit a claim for nonpayment of an invoice that is in dispute.

There is one simple solution to the potential falsification of invoices — have an effective compliance program in place that trains employees and emphasizes the importance of accurate statements in all aspects of government contracting.

8. On multiple award schedule (MAS) contracts, do you give most favored customer pricing to the government throughout the entire life of the contract?

The General Services Administration (GSA) multiple award schedules, also known as federal supply schedules, provide a simplified process for obtaining commercial supplies and services at prices associated with volume buying. The volume of purchases from the schedules is now more than $30 billion annually,

(*continued on the next page*)

even though GSA's volume declined as a result of the Abu Ghraib prison scandal, where the U.S. Army obtained interrogators ands screeners through an MAS contract for information technology. Many contractors think they have reached a state of nirvana when they receive an MAS contract. They think they now have a "license to sell" to the federal government and a continuous stream of revenue. What they overlook are the terms and conditions in the MAS contract, especially the Price Reduction Clause. This clause requires the contractor to reduce prices under its MAS contract if the contractor grants more favorable terms or conditions to another. Many contractors overlook this requirement and the results are not found by GSA until years later during an audit — when GSA demands huge refunds.

The solution to this problem is central control of MAS pricing by the contractor, so that any time a price reduction triggers the clause, the contractor can ensure that all future sales are made at the new, lower price.

9. **Do you volunteer to do extra work?**

Volunteers embark upon duties of their own free will and without any expectation that they will be paid for the work. Government contractors frequently fall into this category in a desire to please their clients. If a contractor freely elects to perform work not required by a contract and without a formal change order, the contractor is a volunteer that will not be paid for the services. Contractors should be wary of any situation where the government asks for services or performance not included in the contract. To be compensated for such a constructive change, the contractor must identify the work, notifying the contracting officer, and request an appropriate change order and equitable adjustment. If the contracting officer refuses, the contractor should not perform the work unless it intends to be a volunteer and perform uncompensated work.

10. **Do you fail to flow down your FAR clauses to your subcontractors and suppliers?**

Many government contracts are complex and require prime contractors to obtain assistance from other contractors to fully perform. A common method is the use of subcontracts between the prime contractor and a subcontractor. A subcontractor is generally any firm that supplies materials or performs services for a prime contractor, pursuant to the requirements of a government contract. Subcontract management is critical.

Certain clauses in the government's prime contract must flow down, i.e., be incorporated into the subcontracts awarded by the prime. These clauses are designed to protect the government's rights and interest and to promote the government policies. Some clauses explicitly mandate flow down to the subcontracts (e.g., the audt clause, the cost accounting standards clause, the equal opportunity clauses), while other clauses implicitly require the flow down (e.g., the Davis-Bacon Act and the Service Contract Act of 1965 clauses). Strangely enough, the government does not require, either implicitly or explicitly, the flow down of the changes clause or the termination for convenience of the government clause. However, it is essential that these two clauses flow down in every subcontract; otherwise the prime contractor will be unable to terminate the subcontractor in the event of a government convenience termination. Similarly, the prime contractor will be unable (absent what could be a monumental price increase) to change the specifications , delivery date, or quantity in response to a government-ordered change order. The subcontract is a commercial contract between two commercial entities, and is subject to the *Uniform Commercial Code* and state laws. The concepts of "change" or "termination for convenience" are not part of commercial contracts, which require mutual agreement by the parties in order to change any term of an existing contract.

Prime contractors should examine their contracts carefully, and whenever there is a doubt in their mind, flow down the prime contract clause to the subcontractor, making appropriate changes in the text. This is normally accomplished by incorporating the text of the clause by reference in the subcontract to its FAR clause number and title, and by stating in the subcontract that "the clauses are incorporated herein by reference with same force and effect as if set forth in full text."

Furthermore, the subcontract should also include a statement that explains that whenever the phrase

(*continued on the next page*)

"government or contracting officer" appears in the clause, it shall be replaced by "subcontractor." Subcontracts often include several pages of clauses incorporated by reference. Whenever there is any doubt, the prime contractor should flow down the substance of the clause in the prime contract to the subcontract, thereby ensuring that the subcontractor will be required to comply with the same terms with which the prime contractor must comply.

Conclusion

While sometimes the product of a government contract is indeed a rocket, the administration of government contracts is not really "rocket science." Effective government contract administration is similar to good business practices in the commercial world. A company examines its problems and procedures, breaks them down and devises working solutions. The larger government contractors use numerous written procedures for administering their government contracts. The smaller (and newer) government contractors need to establish simple, but effective procedures, train their personnel, and heed the lessons learned by their predecessors. Finally, all government contractors should have the ability to call upon government contracts counsel when things go sour, or when the government acts unreasonably and forces the contractor to demand and enforce its rights.

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* - Richard D. Lieberman is a government contracts attorney with McCarthy, Sweeney & Harkaway, PC, in Washington, DC. He handles a wide variety of government contract administration matters as well as bid protests and compliance programs for his clients. This article does not constitute legal advice with respect to any particular transaction. The assistance of Jason D. Morgan, a J.D. candidate at George Washington University Law School, is gratefully acknowledged.

Endnotes

[1] - See FAR 14.201-1.
[2] - FAR 52.252-2.
[3] - See FAR Part 48 and FAR 52.248-1.
[4] - FAR 1.602-1
[5] - See, e.g., Department of Agriculture Acquisition Regulation 416.405-2; Department of State Acquisition Regulation 652.242-70.
[6] - FAR 52.243-1.
[7] - FAR 2.101.
[8] - FAR 46.101.
[9] - FAR 46.202.
[10] - *Cascade Pac. Int'l v. United States*, 773 F.2d 287, 291 (Fed. Cir. 1985)
[11] - *Spring St. Found., Inc.,* AGBCA No. 92-232-1, 94-2 BCA ¶26,737.
[12] - FAR 52.249-8(c).
[13] - FAR 52.249-8.
[14] - *Lisbon Contractors, Inc. v. United States*, 828 F.2d 759, 765 (Fed. Cir. 1987)
[15] - FAR 52.209-5.
[16] - 31 U.S.C. §3901 *et seq*.; see also FAR Part 32.9 and FAR 52.232-25.
[17] -The attributes of an effective government contracts compliance program were explained in my July 1999 article, "Compliance Programs: They're Worth It!", *Contract Management* (Vol. 39, No. 7).
(*continued on next page*)

Ten Big Mistakes in Government Contract Administration (cont'd):

Endnotes (cont'd)

[18] - See FAR Part 8.4.
[19] - GAO-05-201, "Interagency Contracting: Problems with DOD's and Interior's Orders to Support Military Operations," April 29, 2005.
[20] - GSAM 552-238-75.
[21] - *N. Star Ala. Hous. Corp. v. United States*, 30 Fed. Cl. 259, 272 (1993) [citing *Calfon Constr. v. United States,* 17 Cl. Ct. 171, 177 (1989)].
[22] - FAR 52.215-2.
[23] - FAR 52.230-2.
[24] - FAR 52.222-26.
[25] - FAR 52.222-6.
[26] - FAR 52.222-41.
[27] - FAR 52.243-1.
[28] - FAR 52.249-2.
[29] - U.C.C. §2-209.

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Aspects of Construction Scheduling

by

Mark E. Hanson*

["Aspects of Construction Scheduling," by Mark E. Hanson, The Procurement Lawyer, Vol. 42, No. 1, Fall 2006 © 2006 The American Bar Association. Reprinted with permission.]

At all levels, public contracts for construction frequently specify preparation and use of network schedules to plan, determine, and manage progress, assess status, anticipate and overcome potential delaying events, measure payments against progress, and determine extensions of time. Although network scheduling, typically called the critical path method (CPM), generally has seen its most stringent tests in litigation over the 40 years since its introduction to construction, its principles and associated legal concepts are applicable equally in the performance and administration of a project that experiences events delaying construction progress.

Some of the principles discussed herein have been well-established for much of the time during which systematic network scheduling has been in use and are familiar to those experienced in construction and litigation of related disputes. Acquiring familiarity with and the ability to grasp and inquire into CPM techniques, methodologies, and conclusions is essential to construction managers, contract administrators, as well as counsel who may not have such experience. Moreover, techniques, specifications, and the knowledge, understanding, and experience of experts, judges, arbitrators, mediators, and practitioners have advanced over the last two decades, leading to maturation of the field and efforts to standardize its practice as a construction discipline, not unlike the various engineering disciplines. This article presents several basic elements of network scheduling, particularly as it relates to construction law, and some more recent developments further solidifying the requirements of acceptable scheduling practices.

What Is Critical Path Scheduling?

Schedules prior to the advent of critical path method scheduling, while attempting to coordinate the numerous activities that are involved in performing complex manufacturing or construction, suffered from their lack of integration of the time, spatial, and resource relationships between separate activities. Critical path method scheduling is "a graphic presentation of the planned sequence of activities that shows the interrelationships and interdependencies of the elements composing a project." Its network of activities that enables analysis in schedule-related claims is the most frequently used method for planning and managing construction and for the proof and assessment of schedule-related claims. The critical path method establishes a planned sequence of activities, their durations, and their interrelationships and defines the "critical path;" the minimum duration that will be required to complete a project. A delay to any of the critical path activities will extend day-for-day the planned completion date of the project unless other adjustments or changes are made to the relationships between activities or the resources brought to bear to perform the affected activities.

Only those delaying events that affect the schedule's critical path, or that increase the duration of an activity such that it "gets on" the critical path, are relevant to extension of the contractually required completion date and claim analyses involving accelerated or extended performance. Delays are usually identified as excusable or nonexcusable with the former supporting extension of the time for performance, and the consequences of the latter falling exclusively on the contractor.

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Organizational Conflicts of Interest/Edition IV

by
Daniel A. Cantu*

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Organizational conflicts of interest—which arise when a Government contractor is found "unable to render impartial assistance or advice to the government" or has an "unfair competitive advantage"[1]—are notoriously difficult to define with precision.[2] Indeed, the Federal Acquisition Regulation reinforces this perception by leaving the identification and amelioration of a conflict to the discretion of the Contracting Officers, who are to exercise "common sense, good judgment, and sound discretion" in both identifying a significant potential conflict and the appropriate means to resolve it.[3]

Notwithstanding this historical confusion and the wide latitude allocated to the CO under the FAR, an analytical framework has begun to emerge from the decisions of the Government Accountability Office, beginning with the seminal case of *Aetna Government Health Plans, Inc.*[4] in 1995.

In *Aetna*, the GAO recognized that the term "organizational conflict of interest" is really an umbrella that covers three analytically distinct conflict scenarios that render a contractor unable to provide impartial assistance to the Government or give the contractor an unfair advantage in the competition. The first of these scenarios is called "unequal access to information." It occurs where a firm "has access to nonpublic information as part of its performance of a government contract" that leads to "a competitive advantage in a later competition for a government contract."[5]

The second is known as the "biased ground rules" category. It occurs where "a firm, as part of its performance of a government contract, has in some sense set the ground rules for another government contract by, for example, writing the statement of work or specification."[6]

The third category of organizational conflict of interest, for "impaired objectivity," exists where a contract requires the exercise of judgment, and the economic interests of the firm—broadly defined—may be harmed through the free and unbiased exercise of that judgment.[7]

This is the fourth BRIEFING PAPER to address the subject of organizational conflicts of interest. The first, published in 1964, discussed the rules in effect before the issuance of the FAR; the second, published in 1984, discussed the rules in the then newly promulgated FAR; the third, published in 1994, discussed the emerging interpretations of the conflict-of-interest rules.[8] This PAPER, the fourth in the series, focuses on the framework for analyzing conflicts of interest that has emerged from the GAO decisions of the last decade.

Key Principles

The FAR sets forth two key principles underlying the detection and amelioration of organizational conflicts of interest:[9]

(1) Preventing the existence of conflicting roles that might bias a contractor's judgment.
(2) Preventing unfair competitive advantage.

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Aspects of Construction Scheduling (cont'd):

What Is Float and Why Does It Matter?

Scheduled activities not on the critical path are, by definition, those activities having "float;" an amount of time for which delay of that activity will not affect the critical path and extend the time for completion. A critical path activity has no float. Total float is the amount of time an activity can be delayed without delaying the project completion date. It is the difference between the early start and late start or early finish and late finish for a given activity or an entire path of activities in a schedule network.

Float allows a manager the ability to reschedule resources and work, yet not delay the project so long as the float is not consumed. Because of this flexibility associated with float, the question of whether the owner, contractor, or the project "owns" float and is entitled to use it remains a significant issue, particularly in the context of multiple delays that exceed total float. For example, an owner-caused delay consumes available float causing subsequent activities in the chain to be critical, and the contractor is then responsible for an unexcused delay. Depending on the answer to the question "who owns the float," the outcome can be quite different. If it is a resource owned by the contractor and the owner deprived it of that resource (to absorb its unexcused delay) resulting in increased time, for example, to work around the stalled activity, compensation should be due. If a scheduled activity having float is delayed and the delay does not use up the float and cause the activity to become critical, generally no compensation for time-related costs is involved because there is no delay to the overall project completion date—no critical path effect and, therefore, no extended period of performance during which unanticipated costs are incurred.

Absent a contract clause, float can be considered a management tool for the contractor's use, and at least one decision held that float should belong to the party performing the schedule activity having float and that party is "entitled to consume or use the float as he sees fit or necessary." The general approach, however, even in the absence of a contract clause, is that float is a shared resource not the property of the contractor or the owner. This neutral approach effectively means that the party that first uses the float owns it. A contractor can probably recover for increased costs proved to be solely due to owner-caused delays that consumed float, as these circumstances could disrupt the contractor's planned sequencing of work, thus potentially increasing costs as discussed above. The primary problem, as is the case with many construction claims, is developing proof that establishes the causal link between the delay(s) and the contractor's increased costs.

What Makes For a Reliable Schedule?

Where a contract specification requires the contractor to develop a CPM schedule, typically there is also a requirement that the contractor uses the schedule as a management tool in constructing the project and creates a record of project performance through monthly updating, entering start and finish information for the previous month, and reforecasting as necessary. Contractually required schedules generally may not be abandoned without the risk of liability for damages due to other parties' reliance. An obsolete schedule may mislead other parties and subject the party who promulgated the schedule to claims for damages.

Updating the schedule in accord with contract requirements is essential, not only because of likely contract requirements, but because courts have determined that "accurate, informed assessments of the effect of delays upon critical path activities are possible only if up-to-date CPM schedules are

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<u>Aspects of Construction Scheduling (cont'd)</u>:

faithfully maintained throughout the course of construction." The critical path method, and analyses based on CPM schedule networks, is widely accepted by courts and judicial bodies for analyzing delay-related claims for time extension and other effects upon construction. In fact, CPM may be the only way to demonstrate delay and its effects, even if the contract does not require the use of the method. There must be proof establishing through a CPM analysis that the claimed event, such as the late return of submittals, caused delay to the critical path. The recognized method is essentially the comparison of (1) the as planned schedule with (2) the as built schedule developed from project records, principally monthly updates, and (3) analysis of activities performed in longer or shorter time periods than originally planned to identify delays and determine causes and responsibility.

As to the importance of the requirement that a schedule offered to support a claim must be used to manage the project and updated throughout, *Turner Construction Co. v. GSA* recently involved efforts by GSA to prove spoliation of evidence. GSA sought a presumption that the contractor's missing schedule updates would have supported GSA's case and harmed the contractor's case. However, Turner had actually never prepared the updates, thus there was no destruction of evidence, willful or otherwise. Of greatest interest in this case is the board's "observ[ation] that it is appellant who may be prejudiced by the allegedly missing scheduling update data. It is appellant's burden to establish the fundamental facts of causation, liability and damage. . . . Appellant's statements that it did not use Primavera during the later stages of the project, or provide schedule updates as required by the contract, raise questions as to whether appellant will be able to prove delay during the stages of the project for which update data is missing."

Is It Really a Concurrent Delay?

The issue arises because a delay to project completion may be caused by more than a single event. The contractor and owner each may be responsible for one or more of the potential causes of the delay. There may be any number of activities not completed when planned and the question in the face of undeniable extension of project completion is the underlying cause(s) of the delays to completion. "[T]here can be but a single delay over a given period of time, and when that delay has multiple, indivisible causes, it is attributable not to either party but to both. Hence, it would probably be more accurate to speak not of concurrent delays but of a single delay with concurrent causes." This conclusion illustrates the historic problem the courts faced in attempting to address competing, simultaneous causes of delay and led to the general rule that "inextricably intertwined" causes of delay will not permit the contractor to recover extended duration costs or the owner to recover liquidated damages for late completion.

While the courts struggled with how to deal with concurrent causes of delay, including compensable delays concurrent with noncompensable delays, the current approach, given the availability of CPM analysis, is to require the claimant to carry its burden of proof by segregating or apportioning the delays and the associated expenses that are the responsibility of each party. "Concurrent delay is not fatal to a contractor's claim for additional time due to excusable delay, but precludes the recovery of delay damages." A contractor may be required to prove when it would have completed "but for" owner-caused delays. However, this requirement subsumes the principle that the contractor must establish that the compensable, or owner-caused, delay affected the critical path while the contractor-caused delay was to an activity or activities that were not critical and carried float. In view of this, a "delay" of an activity carrying float is not a "delay" at all in relation to concurrent delay, as recently confirmed in *George Sollitt Construction*.

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Aspects of Construction Scheduling (cont'd):

However, there is some confusion in the federal contracting decisions as to whether or not the contractor must disprove its responsibility for possible concurrent delays. *MCI Constructors* and *Bechtel Environmental* establish this is not necessary, but *PCL Construction* effectively requires the contractor to demonstrate the government was the "sole proximate cause" of the delay to the exclusion of the possibility that any other concurrent cause would have delayed the project. One commentator suggests the court's expression may have been prompted by the contractor's assertion of a "total time" claim that attributed all delay to the government.

Frequently, a contractor's failure to perform to planned sequences and activity dates once it has experienced critical path delays attributable to the owner is asserted as concurrent delay; that is as an independent cause of the delay. There have been several cases essentially finding that the contractor "is not necessarily required to conduct all of its other construction activities exactly according to the pre-delay schedule, and without regard to the changed circumstances resulting from the delay. The occurrence of a significant delay generally will affect related work, as the contractor's attention turns to overcoming the delay rather than slavishly following its now meaningless schedule." Thus, a contractor is permitted to not "hurry up and wait" and can effectively relax its performance of work that is not on the critical path thereby avoiding valid assertions of concurrent delay.

Conclusion

As time is the single most important component in a construction project, many of the problems that occur during construction relate to the project schedule. CPM schedules and analysis therefore are a key resource whether the problem is addressed contemporaneously or in dispute resolution. This article has introduced just a few of the basic principles of scheduling and associated requirements essential to understanding the nature of construction scheduling and its treatment by the courts and boards of contract appeals. Such topics as the use of scheduling in relation to analyzing effects upon construction productivity and acceleration of performance may be the subject of future articles. Sources of more in-depth information about construction scheduling are cited herein and reference to those works is recommended. To grasp these topics more fully, however, there is no substitute for review of the decisions of the Court of Federal Claims and the boards of contract appeals. State and local jurisdictions may vary somewhat.

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Endnotes

[1]—*See*, e.g., publications of The Association for the Advancement of Cost Engineering (AACE), The Society of Construction Law, Association of General Contractors and the Project Management Institute (PMI).

[2]—Jon M. Wickwire *et al.*, CONSTRUCTION SCHEDULING: PREPARATION, LIABILITY, AND CLAIMS 23-24 (Aspen 2003).

[3]—*Id.* at 24.

[4]—Hubert J. Bell, Jr. and Gene J. Heady, *Expertise That Is "Fausse" and Science That Is Junky: Challenging a Scheduling Expert*, PROCUREMENT LAWYER, Vol. 35, No. 1 at 7 (Fall 1999). Precedence Diagram Method (PDM) is another form of CPM that is increasingly used.

[5]—Id. At 11 n.1.

[6]—Marion Constr. Co. v. Gen. Servs. Admin., GSBCA No. 13625, 98-1 BCA ¶29,685; *Galaxy Builders, Inc.*, ASBCA No. 50018, 50136, 00-2 BCA ¶31,040.

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Aspects of Construction Scheduling (cont'd):

Endnotes (cont'd)

[7]—*Utley-James, Inc*., GSBCA No. 5370, 85-1 BCA ¶17,816.
[8]—*Maron Constr*., 98-1 BCA at 147,109.
[9]—*Turner Construction Co*., ASBCA Nos. 25447, 29472, 29591, 29593, 29830, 29851, 29852, 90-2 BCA ¶22,649. *See also Joseph E. Bennett Co*., GSBCA 2362, 72-1 BCA ¶9364, n.7 (1972); *Heat Exchangers, Inc*., ASBCA No. 8705, 1963 BCA ¶3881 (1963); *cf. Blackhawk Heating & Plumbing Co*., GSBCA No. 2431, 75-1 BCA ¶11,261, *on recon.* 76-1 BCA ¶11,649 (1975).
[10]—Adrian L. Bastianelli III, Andrew D. Ness, Joseph D. West, Federal Government Construction Contracts 428 (ABA Pub. 2003)(citing Wickwire et al., Construction Disputes: Representing the Contractor 519, 538 (3d ed. 2001)).
[11]—*Id*., at 436-37, 446-47, 462-69.
[12]—Natkin & Company v. George A. Fuller & Western Electric Co., Inc., 347 F.Supp. 17 (W.D. Mo. 1972)(owner and prime contractor abandoned schedule and became liable for subcontractor's damages).
[13]—*Compare Natkin*, 347 F.Supp. 17 and Edwin J. Dobson, Jr. Inc. v. Rutgers State University, 90 N.J. 253 (1982)(A party is generally free to schedule a project as it sees fit).
[14]—Blinderman Constr. Co., Inc. v. United States, 1997 WL 719912 at 57 (Fed. Cl. 1997); Fortec Constructors v. United States, 8 Cl. Ct. 490, 506 (1985); *Continental Consol. Corp*., ENG BCA Nos. 2743, 2766, 67-2 BCA ¶6624 at 30,715 (1967).
[15]—*See*, *e.g*., *Fischbach & Moore Int'l Corp*., ASBCA No. 1146, 77-1 BCA ¶12,300 (1976); *American Int'l Contractors, Inc./Capitol Indus. Constr. Groups, Inc*., JV, ASBCA Nos. 39544, 42663, 42855, 42878, 44393, 44395, 44470, 44485, 95-2 BCA ¶27,920 (1995); Kelso v. Kirk Bros. Mechanical Contractors, Inc., 16 F. 3d 1173, 1177 (Fed. Cir. 1994).
[16]—*See G. Bliudzius Contractors, Inc*., ASBCA Nos. 42366, 42368-42370, 93-3 BCA ¶26,074 at 129,593 (1993); Sunshine Construction & Eng'g, Inc. v. U.S., 64 fed. Cl. 346, 368-69 (2005)(only recognized methods of CPM analysis are acceptable proof).
[17]—Turner Construction Co. v. GSA, GSBCA Nos. 15502, 16055, 16551, 2005-1 BCA ¶32,898 at 162,986.
[18]—*Sunshine Constr*., 54 Fed. Cl. At 368-69.
[19]—*Turner Constr*., 05-1 BCA ¶32,895 at 162,968 (citations omitted). Primavera Project Planner is one of the currently available scheduling software programs.
[20]—*Utley James, Inc*., 85-1 BCA ¶17,816 at 89,109.
[21]—*See, e.g.,* Commerce Int'l Co. v. United States, 338 F.2d 81 (Ct. Cl. 1964); *C.D. Murray Co.*, ENG BCA No. 5018, 89-1 BCA ¶21,275; United States v. United Eng'g & Constructing Co., 234 U.S. 236 (1914).
[22]—Blinderman Construction Co. United States, 695 F. 2d 552, 559 (Fed. Cir. 1982).
[23]—R.P. Wallace v. U.S., 63 Fed. Cl. 402, 410 (2004)(noting the basis of the rule is absence of causation). This case also includes an enlightening discussion of the unsettled law regarding the effect of causes of delays attributable to each of the parties that occur seriatim.
[24]—*See Utldey James, Inc*., 85-1 BCA ¶17,816; *Fischbach & Moore Int'l Corp*., ASBCA No. 18146, 77-1 BCA ¶12,300.
[25]—George Sollitt Construction Co. v. United States, 64 Fed. Cl. 229, 240-41 (2005).
[26]—*MCI Constructors, Inc*., DCCAB No. D-924, 1996 DCBCA Lexis 71 (June 4, 1996).
[27]—*Bechtel Environmental, Inc*., ENG BCA Nos. 6137, 6166, 97-1 BCA ¶28,640.
[28]—See PCL Construction Services, Inc. v. United States, 47 Fed. Cl. 745, 801 (2000).

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Using All the King's Horses For Homeland Security: Implementing the Defense Production Act For Disaster Relief and Critical Infrastructure Protection

by

J. Michael Littlejohn*

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Implementing the Defense Production Act (cont'd):

I. Introduction

The response to Hurricane Katrina has brought intense scrutiny from Congress, the media, and the public. The response has its success stories, but it has also raised questions about the ability of the Federal Government to provide effective, efficient assistance to states in responding to major disasters and potential terrorist threats with the current authorities in the Robert T. Stafford Disaster Relief And Emergency Assistance Act ("The Stafford Act")[1] and the Homeland Security Act.[2] Based on some of the reports, testimony, and press coverage, there may be serious concerns about the Government's ability to engage its most important ally in the response to natural disasters, terrorists attacks, and protecting infrastructure -- the business community. The House Select Committee in reviewing the Katrina response concluded that businesses may not be so willing to help the Government in future disasters. The Committee's report concluded with the following:

> The intense public scrutiny could limit the willingness of private sector companies to offer assistance during future disasters. Several firms expressed the view that the challenges associated with emergency contracting may not be worth the trouble. Finally, unfounded negative publicity harms company reputations. Public sector missions divert company assets from primary missions and could raise questions about whether a company was meeting its fiduciary duty to shareholders. Given the important role the private sector played in all aspects of the response and recovery, any loss of private sector involvement could be critical.[3]

Accordingly, it is even more important for the Government and business to understand the authorities that can be implemented to respond to natural disasters or terrorist events. Based on legislative changes in 1994, the Defense Production Act of 1950[4]and the Defense Priorities and Allocations System (DPAS)[5] apply to disaster relief and, based on changes in 2003, it can also be implemented for the "critical infrastructure protection and restoration" whether the infrastructure is owned by federal, state, local, or private concerns.[7]

The application of the DPAS could be valuable asset in responding to future disasters and protecting or restoring critical infrastructure, especially where businesses are less than willing to work with the Government. The Defense Production Act and the implementing regulations allow the Government (or other designee) to issue orders for goods or services that must be fulfilled or the business could face civil or criminal penalties. Indeed, the DPAS could play a vital role in response to future natural disasters, health epidemics, or terrorist attacks. This article explores some of the history of the Defense Production Act, the decision to apply it to emergency response and critical infrastructure protection, and how the Government has adapted it to the fight against terrorism.

II. Background on the Defense Production Act

Most old-timers in Government contracts know the Defense Production Act and the DPAS from its traditional application by the military, who required contractors on certain programs to provide goods or services needed for the national defense to the Government before the contractor fulfills other contractual obligations. For example, under the Defense Production Act, the DOD might issue "rated" orders to major weapons systems contractors that require the contractors to meet the Governments needs before performing other work. The Act also allows the Government to require companies to use products in inventory to meet the Government's order or to provide products that have been sold by a business within the last two years,

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Unraveling the Mixed Message
Government Procurement Personnel Receive:
Message 1: Act Absolutely in the Government's "Best Interests"
Message 2: Act "Ethically"

by
Stuart B. Nibley

[*Note: "Unraveling the Mixed Message Government procurement personnel Receive: Message 1: Act Absolutely in the Government's 'Best Interests' Message 2: Act 'Ethically'"," by Stuart B. Nibley, American bar Association Public Contract Law Journal, Volume 36, No. 1, Fall 2006. ©2006 by the American Bar Association. Reprinted with permission.]*

I. The Mixed Message: 1) You have a Duty to Deal with Contractors Fairly and in Good Faith; 2) Any Act You take in Your Official Contracting Capacity is Almost Conclusively Presumed to be in Good faith (i.e., Meets This Duty).

A. Introduction

B. A Number of Court Decisions Have Conflated Two Distinct Legal Principles Leading to the Mixed Message: 1) the Duty (Implied Into Every Contract) That Government Employees Deal Fairly And In Good Faith With Contractors, and 2) The Presumption That Government Employees Act in Good Faith Under Other Circumstances

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IV. Conclusion: What Should Be Done?

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Mixed Messages (cont'd):

I. The Mixed Message: 1) You have a Duty to Deal with Contractors Fairly and in Good Faith; 2) Any Act You take in Your Official Contracting Capacity is Almost Conclusively Presumed to be in Good faith (i.e., Meets This Duty).

A. Introduction

A whitepaper and an article recently written by two of the government contractingbar's most experienced attorneys have sparked a spirited discussion within the bar. In May 2005, Marshall Doke, a member of the Commercial Practices Working Group,[1] sent a proposal to his colleagues calling for the group to recommend legislation to amend the federal procurement laws to provide substantially as follows: "Except as otherwise expressly required by statutes, the same rules of interpretation and performance of contracts and the liabilities of the parties shall be applied in the same manner to the Government and to contractors."[2] Mr. Doke noted that the "recommendation merely [would] adopt the view consistently expressed by the Supreme Court of the United States."[3]

In October 2005, Stanfield Johnson authored a "Guest Appearance" special column in Thomson/West's *Nash & Cibinic Report*.[4] The proposals advanced by Messrs. Doke and Johnson were brought before the Council of the ABA's Section of Public Contract Law, and the issue was joined. The government contracts bar now considers a number of questions relative to the issue. In my view, the essential questions presented and the correct answers are as follows:

1. Should the judicially-created principle that government procurement personnel acting in their contractual capacities are presumed to act in good faith be legislatively or otherwise extinguished?

   Answer: Yes

2. Would the government contracting community, or the tax-paying community in general, benefit from the implementation of a "code" or set of principles that articulates and explains the duty that government and contractor personnel both have to deal with one another fairly and in good faith?

   Answer: Yes

These two questions give rise to several other questions, including but not limited to

3. Is there a true need to address either issue?

   Answer: Yes

4. Are the two issues actually connected?

   Answer: Yes

5. Should the focus be on government personnel only?

   Answer: No

B. A Number of Court Decisions Have Conflated Two Distinct Legal Principles Leading to the Mixed Message: 1) the Duty (Implied Into Every Contract) That Government Employees Deal Fairly And In Good Faith With Contractors, and 2) The Presumption That Government Employees Act in Good Faith Under Other Circumstances

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Organizational Conflicts of Interest (cont'd from p. 14):

Under the FAR, the CO has primary responsibility to "[i]dentify and evaluate potential organizational conflicts of interest" and to "[a]void, neutralize, or mitigate significant potential conflicts before contract award."[10] "The exercise of common sense, good judgment, and sound discretion is required in both the decision on whether a significant potential conflict exists and, if it does, the development of an appropriate means for resolving it."[11] When a significant conflict is identified, such conflicts "are normally resolved by imposing some restraint, appropriate to the nature of the conflict, upon the contractor's eligibility for future contracts or subcontracts."[12]

Although there are no specific disclosure requirements in the FAR, prospective contractors should identify potential organizational conflicts and propose a mitigation plan to the Government. This plan must cover the firm's parent company and subsidiaries, affiliates, joint venture partners, and other related entities. Although the FAR does not explicitly discuss organizational conflicts that arise because of related entities, the decisions of the GAO leave no doubt that related entities are an essential part of the analysis. Options for mitigating potential conflicts include:[13]

(a) Imposing organizational barriers (or firewalls) within the firm's corporate structure or between various members of the contracting team.
(b) Isolating subcontractors from planning or developmental aspects of the contract.
(c) Segregating records, personnel, or contracting teams.
(d) Altering corporate structures, divisions, or entities to reduce the impact of an organ izational conflict, including the sale of smaller units that may give rise to the con flict.

In describing specific instances of organizational conflicts of interest, the FAR sets forth a complicated set of examples, illustrating nine possible scenarios.[14] Although these scenarios are valid law (if somewhat confusing), the GAO in *Aetna* simplified the analysis into three categories: (1) unequal access to information, (2) biased ground rules, and (3) impaired objectivity. Each of these categories has its own unique characteristics and remedies. The following discussion describes each of these categories and illustrates them with examples of cases adjudicated by the GAO.

Category 1: Unequal Access To Information

The FAR provides that an organizational conflict based on unequal access to information exists where a contractor competing for a award of a Government contract possesses *proprietary information* "that was obtained from a Government official without proper authorization," or *source selection information* "that is relevant to the contract but is not available to all competitors, and such information would assist that contractor in obtaining the contract."[15]

Notwithstanding the FAR's definition, the GAO has rephrased this language into a broader concept, holding that an organizational conflict of interest of this type occurs where a firm "has access to *nonpublic information* as part of its performance of a government contract" that leads to "a competitive advantage in a later competition for a government contract."[16] As interpreted by the GAO, the phrase "nonpublic information" is a term of art. Although incumbent contractors often have access to information not generally available that lends them an advantage in subsequent competitions, such information does not lead to an organizational conflict of interest. The GAO summarized this principle in *Snell Enterprises, Inc.*: "The mere existence of a prior or current contractual relationship between a contracting agency

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Organizational Conflicts of Interest (cont'd):

and a firm does not create an unfair competitive advantage, and an agency is not required to compensate for every competitive advantage gleaned by a potential offeror's prior performance of a particular requirement."[17] For purposes of an organizational conflict-of-interest analysis, nonpublic information must be highly specific confidential information that can be identified using "substantial facts and hard evidence"[18] and that would not ordinarily be available to an incumbent. An important subcategory of nonpublic information is proprietary information belonging to another firm that was not disseminated to other firms in the competition.

In examining an "unequal access" conflict, the GAO has focused on the following questions:

(1) Did the bidder have useful information beyond that of an ordinary incumbent?
(2) Can the information be identified using "substantial facts and hard evidence"?
(3) Was the information proprietary to another company, or was it freely disseminated?

All of these factors can be gleaned from a careful examination of recent decisions by the GAO.

More Than An Ordinary Incumbent

The first question to address with this type of organizational conflict of interest is whether the bidder had more information than an ordinary incumbent. Answering this question requires a fact-intensive inquiry, as illustrated in *Johnson Controls World Services, Inc.*[19]

Johnson Controls involved a protest of an award for logistical services at a military base. The protester alleged that the successful bidder had nonpublic information through one of its subcontractors and should have been excluded because of an organizational conflict of interest. The subcontractor established and maintained a logistical database for the military and compiled detailed information relating to maintenance activities worldwide. It also provided general assistance to the Government in evaluating logistical needs and planning.

The GAO began its analysis with an examination of whether the information would be of use to a bidder on the contract. This was accomplished by comparing the information available to the subcontractor to that available on the request for proposals. After a detailed analysis, the GAO found that the subcontractor possessed much more detailed information than was available through the RFP. For example, the RFP provided general information relating to the number of weapons and work orders. The subcontractor, however, had access to detailed information relating to the specific types of weapons repaired and the parts used for repair. From this and similar information, the GAO found that the information "would make it possible to refine and reduce staffing levels significantly beyond what would be possible using the RFP information alone."[20] Furthermore, the GAO noted that the subcontractor's employees were "embedded in [the Government] organization and know everything that goes on to include the number of people [used] to conduct maintenance and supply."[21]

After identifying the information as valuable, the GAO addressed whether the information possessed by the subcontractor was essentially the same as would be possessed by any incumbent. The agency found this not to be the case. The subcontractor's work included "provid[ing] the agency with analysis and evaluation of how the work is (and should be) performed."[22] Because an ordinary incumbent would generally not know how the agency evaluates its work, an organizational conflict of interest existed.[23]

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Organizational Conflicts of Interest (cont'd):

Substantial Facts & Hard Evidence

As a practical matter, the GAO is skeptical of allegations of unequal access to information and has emphasized that the conflict must be established using "substantial facts and hard evidence," as opposed to "mere inference or suspicion of an actual or apparent conflict."[24] This is shown in *Mechanical Equipment Co.*,[25] which bears a striking, albeit superficial, resemblance to the facts of *Johnson Controls*.

In *Mechanical Equipment*, the protester alleged that a subcontractor had a long-term support services contract with the agency and may have been involved in developing the requirements for the solicitation. Unlike *Johnson Controls*, however, the GAO found no conflict. The GAO determined that the subcontractor "had a very limited role in the [relevant] program that did not provide it with an unfair competitive advantage."[26] Indeed, the key documents for the competition, "including the RFP, the statement of work, the purchase description, the test and evaluation master plan, milestone decisions and the life cycle cost estimate, were created after [the subcontractor's] contract with [the agency] ended."[27] Moreover, much of the supposedly confidential information obtained by the subcontractor had been publicly released in a *Commerce Business Daily* announcement.[28]

Failing in this argument, the protester contended that the subcontractor—like the subcontractor in *Johnson Controls*—was "so 'embedded' as to provide [the subcontractor] with insight into the agency's operations beyond that which could be expected of a typical government contractor."[29] The GAO also rejected this argument, stating that "the record before us here, which includes the agency's credible testimony that [the subcontractor] had very little to do with the [relevant] program, does not support anything beyond speculation that [the subcontractor] may have had access to such information."[30] The GAO noted further that the "mere proximity" to the Government's estimate of the labor hours to be performed by the subcontractor in the awardee's proposal did "not rise above innuendo and suspicion" and did not provide a basis to sustain the protest.[31] The GAO stressed in this decision that "[s]ubstantial facts and hard evidence are necessary to establish a conflict; mere inference or suspicion of an actual or apparent conflict is not enough," and that it "will not overturn an agency's determination as to whether an offeror or potential offeror has a conflict of interest except where it is shown to be unreasonable."[32]

Proprietary Information

The FAR provides that "[w]hen a contractor requires proprietary information from others to perform a Government contract… the contractor may gain an unfair competitive advantage unless restrictions are imposed."[33] Such restrictions are not intended to protect information "[f]urnished voluntarily without limitations on its use" or available from other sources "without restriction."[34]

Thus, the use of proprietary, nonpublic information to obtain a contract will create an organizational conflict of interest, unless that information was available to other firms in the competition. In *Snell Enterprises, Inc.*,[35] the protester contended that the contract awardee had used proprietary information from another firm to win the contract. The GAO rejected that argument because the information "was furnished voluntarily, with no stated limitations on its use, and all government and [contractor] personnel in attendance understood it to be property of the U.S. Government."[36]

Implications

As a practical matter, unequal access to information conflicts are most likely to arise where the (*continued on next page*)

Organizational Conflicts of Interest (cont'd):

bidder is using proprietary information belonging to another firm, or where the contractor (or subcontractor or affiliate) provided general advice to the Government that gave it a unique insight into the bidding or evaluation process. This type of conflict should generally be easy to remedy by creating organizational barriers between those corporate divisions, affiliates, or individuals with access to the nonpublic information and those bidding on the new contract. Indeed, the GAO in *Johnson Controls* indicated that a firewall might have been of use in that case, although the barrier in that particular instance had in fact been breached.[37] The presence of proprietary information, particularly information owned by a potential bid protester, complicates mitigation, although this too can be remedied where that information was available to all bidders.

Category 2: Biased Ground Rules

The FAR provides that "[i]f a contractor prepares, or assists in preparing, a work statement to be used in competitively acquiring a system or services…that contractor may not supply the system, major components of the system, or the services unless—(i) [i]t is the sole source; (ii) [i]t has participated in the development and design work; or (iii) [m]ore than one contractor has been involved in preparing the work statement."[38]

The GAO has rephrased this language to convey the broader principle that an organizational conflict of this type occurs where "a firm, as part of its performance of a government contract, has in some sense set the ground rules for another government contract by, for example, writing the statement of work or specification."[39] The concern is that "the firm could skew the competition, whether intentionally or not, in favor of itself," or that the firm "by virtue of its special knowledge of the agency's future requirements, would have an unfair advantage in the competition for those requirements."[40]

In identifying whether a "biased ground rules" conflict exists, the GAO has employed the following three-step analysis:

(1) Did the bidder "set the ground rules" for a competition, either by drafting the specifications or the RFP or by taking a substantial role in doing so?
(2) Did the firm receive an "actual benefit" in the competition as a result of setting the ground rules?
(3) Was the firm is responsible for development and design of the overall system?

Each of these questions will be addressed in turn.

Setting The Ground Rules

As a rule, it should not be difficult to determine whether a firm set the ground rules for a competition. If the firm wrote the statement of work for a contract or drafted the RFP, the answer is yes. The question is somewhat more difficult, however, when the firm did not write the specifications, but rather advised the Government agency on a related topic.

This scenario occurred in *Lucent Technologies World Services, Inc.*,[41] in which Lucent protested its exclusion from a competition for wireless radios and equipment. Lucent had prepared technical

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Organizational Conflicts of Interest (cont'd):

specifications for certain devices that ultimately formed the basis for the specifications in the RFP. In its protest, Lucent argued that the organizational conflict-of-interest restrictions only apply to "complete specifications" for "non-developmental items."[42] The GAO rejected this argument, noting that "contracting officers are given "broad discretion" in the handling of organizational conflicts of interest and the identification of such a conflict under such circumstances "was reasonable."[43]

Actual Benefit

In general, the GAO presumes that "setting the ground rules" confers an "actual benefit" in the form of a competitive advantage on the bidder.[44] In *SSR Engineers, Inc.*,[45] for example, a company protested the Government's decision to exclude it from bidding on an electrical distribution system at a military base. The company had prepared a long-range plan for such systems and drafted a section of the plan that was used as the statement of work for the protested procurement. The company argued, in part, that it should not be excluded from the competition because it did not derive any competitive advantage from drafting the long-range plan. The company contended, in effect, that setting the ground rules did not in fact help it because it should have won the competition even if it had not set the ground rules.[46] The GAO declined to follow this line of reasoning. As the GAO explained in *Lucent Technologies*, "even the appearance of an unfair competitive advantage may compromise the integrity of the procurement process, thus justifying a contracting officer's decision to err, if at all, on the side of avoiding the appearance of a tainted competition."[47]

Nevertheless, there is at least one case in which the protester failed to show an actual benefit. In *American Management Systems, Inc.*,[48] a frustrated bidder protested that the "significant business relationships" based on a "Marketing Alliance Agreement" between KPMG Peat Marwick, the agency's "integration systems partner," which had set the ground rules for the contract, and Oracle, the successful bidder for the software procurement, created an organizational conflict of interest that should prevent Oracle from being awarded the contract.[49] In essence, the protester argued that both firms would benefit in the long run from the success of the other.[50] The GAO rejected this argument. The marketing agreement expressly stated that "the parties remain independent contractors and that no partnership, joint venture, or agency relationship is created between them."[51] The GAO explained that "the potential benefit to KPMG here is speculative and too remote from the present procurement to establish a significant organizational conflict of interest that the contracting agency must avoid, neutralize or mitigate pursuant to FAR Subpart 9.5."[52]

Thus, although actual benefit is ordinarily presumed when the firm sets the ground rules for the competition, no such benefit will be presumed where that benefit is not based on an actual corporate affiliation

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Development & Design Exception

Once it has been established that a firm set the ground rules for a competition, the only practical way to avoid an organizational conflict of interest is under the development and design exception. Where a company has developed and designed a product or system, that company may bid on subsequent contracts even if it did set the ground rules for the competition.[53] The U.S. Court of Federal Claims explained that this exception is a practical necessity in development work.[54] The court noted, quoting the FAR, that "[i]n development work, it is normal to select firms that have done the most advanced work in the field."[55] Such firms can frequently start production earlier, and more knowledgeably than firms that did not (*continued on next page*)

Organizational Conflicts of Interest (cont'd):

participate in development.[56] In many cases, the Government financed the development.[57] Thus, as the FAR states, "while the development contractor has a competitive advantage, it is an unavoidable one that is not considered unfair; hence no prohibition should be imposed."[58]

Implications

Although this type of conflict is relatively easy to identify where the firm has drafted an RFP or other specifications of the contract, *SSR Engineers, Inc.* shows that this type of conflict can also be created by writing long-range plans or providing general advice to the agency.[59] As a practical matter, the company should keep track of all contracts for long-range planning or other consulting advice and develop a plan for segregating the offices, divisions, or personnel working on such matters from the rest of the company.

Category 3: Impaired Objectivity

The third class of organizational conflicts of interest—the "impaired objectivity" category—identifies conflicts where "a firm's work under one government contract could entail evaluating itself, either through an assessment of performance under another contract or an evaluation of proposals."[60] The central concern is that "the firm's ability to render impartial advice to the government could appear to be undermined by its relationship with the entity whose work product is being evaluated."[61]

The GAO has applied a three-part analysis in identifying the "impaired objectivity" type of conflict:

(1) Does the contract at issue require the exercise of judgment by the contractor?
(2) If so, will the firm *ever* be in a position to evaluate itself?
(3) Even if the firm is not evaluating itself, will providing impartial advice adversely impact *any* of the firm's economic interests?

Each of these questions will be addressed in turn.

Exercise Of Judgment

A contractor exercises judgment whenever it evaluates performance, except for contracts devoted exclusively to data gathering. The key case on this topic is *PURVIS Systems, Inc.*,[62] which involved a protest of the Navy's award of a contract to Northrop Grumman Defense Missions Systems, Inc. to provide analytical and technical support to assess the readiness and effectiveness of the Navy's surface forces. The protester contended that Northrop Grumman had an organizational conflict of interest because the contract called on it to evaluate the performance of undersea warfare systems that it had manufactured. The Navy responded that the contract required only data gathering, with no exercise of judgment.[63] The GAO disagreed. Upon a detailed review of the RFP, the GAO found numerous instances in which Northrop Grumman would be required to exercise discretion. The GAO pointed out, for example, that the contractor was responsible for to "drafting scenarios to test specific tactics," and "recommending settings for mine simulators."[64] After reciting a number of other, similar examples, the GAO rejected the agency's contention that subjective judgment was not required.[65]

In *Computers Universal, Inc.*,[66] by contrast, the protester challenged a contract award for
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Organizational Conflicts of Interest (cont'd):

information management services in support of a vehicle tracking system. The alleged organizational conflict of interest arose because the awardee was also in charge of maintaining the vehicles to be tracked. Although the new contract required the firm to "monitor," in a sense, its own performance in maintaining vehicles, the GAO found that it was "not responsible for making judgments as to what maintenance [was] required or how well the maintenance [was] being performed."[67] As such, no independent judgment was required and there was no organizational conflict of interest.

Taken together, these two cases stand for the principle that a firm will be deemed to be exercising judgment whenever it is either evaluating performance or designing an evaluation system. There is no exercise of judgment, however, when the firm's role is limited to gathering data.

Self-Evaluation

The FAR provides that "[c]ontracts for the evaluation of offers for products or services shall not be awarded to a contractor that will evaluate its own offers for products or services, or those of a competitor, without proper safeguards to ensure objectivity to protect the Government's interests."[68] *Any* task that would require a contractor to evaluate its own products and services—even old products or those of an affiliate[69]—falls under this restriction.

An examination of *PURVIS Systems, Inc.*,[70] is instructive on this point. Although Northrop acknowledged that it manufactured 12 of the 59 undersea warfare systems that it would evaluate, the company argued that "mature, fielded" systems do not pose a threat of an organizational conflict of interest.[71] The GAO forcefully rejected this argument, stating that *any* situation in which a company evaluates itself gives rise to an organizational conflict of interest, whether or not the systems at issue involve new procurements. Indeed, any situation in which a company is responsible for assessing the performance of any system that it manufactured is a "classic example of an 'impaired objectivity'" organizational conflict of interest.[72] In such situations, the firm risks having its objectivity impaired by a bias in favor of its own systems' performance and against that of its competitors.[73]

Although the *PURVIS Systems* decision seems to imply that the GAO will, when in doubt, assume that the contractor is evaluating itself, there is a limit to this rule. An analysis of *LeBoeuf, Lamb, Greene & MacRae*,[74] shows that the self-examination must be a *required* element of the contract, not incidental to it. In *LeBoeuf*, a law firm protested the award by the Department of Energy of a contract for professional legal services in connection with a repository of spent nuclear fuel and high-level radioactive waste. The work included the preparation of written analyses and recommendations related to regulatory and licensing requirements. The protester contended that the law firm awarded the contract suffered from an organizational conflict of interest because it had previously provided the same legal services under an earlier subcontract, and the new contract would necessarily require a review of that earlier work.[75] The GAO rejected the argument, concluding that a detailed examination of the award revealed that it was nothing more than a continuation of the previous contract that did not require an evaluation of that prior work.[76]

These cases indicate that self-evaluation, if it exists, should be evident on the face of the contract.

Impact Of Impartial Advice On Economic Interests

Even if the contractor is not explicitly evaluating itself, the GAO has found impaired objectivity

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where impartial advice may adversely impact *any* of the firm's economic interests. In *Alion Science & Technology Corp.*,[77] for example, the protester challenged the award of a contract by the Department of Defense to provide electromagnetic spectrum engineering services. The protester alleged that the awardee had significant interests in the manufacture and marketing of spectrum-dependent products that would impair its objectivity in rendering advice to the Government.

In its review, the GAO found that the company had "multiple financial interests with regard to manufacturing and marketing of spectrum-dependent products to the U.S. government, to foreign governments, and to commercial customers worldwide," and that its future success depended upon both domestic and foreign regulations, its ability to win contracts, and the development and marketing of new products.[78] In reviewing the contract, the GAO found that it required the firm to provide general "technical advice," which involved "analyzing national and international electromagnetic spectrum issues and advising executive decision-makers on the technical viability of policy and implementation options."[79] Noting that the DOD "is competing for spectrum access with other users, including industry and foreign governments," the GAO reasoned that the DOD's policies, strategies and regulations may affect the sale of products by the firm and its competitors.[80] Because the firm may benefit economically from some DOD policies, and be harmed by others, the GAO found that the firm would not be free to provide impartial advice and would therefore be subject to an organizational conflict of interest.[81]

Another example of an organizational conflict of interest based on the economic interests of the company, broadly defined, is presented in *Science Applications International Corp.*[82] That case involved a protest of an award of a contract by the U.S. Environmental Protection Agency to Lockheed Martin Services, Inc. Under the contract, Lockheed would be required to provide "a wide variety" of systems engineering services "to assist EPA in meeting its strategic objections and responsibilities under Federal legislation and executive orders."[83] The protester alleged that Lockheed was subject to an organizational conflict of interest because of its "multiple ongoing activities that are subject to, and potentially in violation of, EPA regulations."[84]

The EPA responded that there was no conflict of interest because the procurement was for computer and engineering services, "not enforcement or regulatory advice."[85] The GAO rejected this argument, finding that the possibility of an enforcement or regulatory action against Lockheed could affect its ability to perform the contract. The GAO pointed out that the contract called for the design and implementation of questionnaires and surveys to meet EPA requirements. These surveys could be used to determine long-term contaminant ingestion and its corresponding health effects. At the GAO hearing, the Government witness testified that it would be inappropriate for Lockheed Martin to conduct a survey in an area where a Lockheed Martin production facility was located, concluding that such a survey "would clearly be a conflict of interest."[86] With this and similar examples, the GAO sustained the protest.

These decisions demonstrate that an organizational conflict of interest may be found *outside* of the four corners of the contract where a protester can raise a plausible argument that the firm may itself be affected by the policy judgments of the federal agency that it advises.

Implications

This is the most troubling of the three categories of organizational conflict, in that it raises the possibility that large firms with diversified interests may be effectively precluded from bidding on contracts that call on them to provide policy advice or otherwise exercise independent judgment. Interestingly, the GAO in *Alion* raised the possibility that this type of conflict can be ameliorated by a firewall because it

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Organizational Conflicts of Interest (cont'd):

remanded the case to the agency for a determination of whether an adequate firewall can be constructed.[87] Nevertheless, it is difficult to imagine how imposing an organizational barrier that segregates offices providing policy advice from the rest of the firm would address the concerns underlying the conflict. After all, the mere fact that the individuals providing policy advice to the Government are *themselves* aware of the impact of that advice on their own firm may be sufficient to alter the content of that advice. In the final analysis, divestiture of the unit responsible for providing policy advice to the Government may be the only practical way to address the GAO's concerns.

Guidelines

These *Guidelines* are intended to assist you in identifying and mitigating organizational conflicts of interest. They are not, however, a substitute for professional representation in any specific situation.

1. Each of the three major categories of organizational conflict (unequal access to information, biased ground rules, and impaired objectivity) should be separately addressed in a mitigation plan. Each has separate elements of proof and may require different mitigation strategies.

2. In drafting a mitigation plan, identify all contracts that involve the use of proprietary information, as well as contracts that provide unusual insight into an agency's decision-making process in awarding contracts. Both are essential for identifying and responding to conflicts due to unequal access to information.

3. Track contracts that "set the ground rules" for future procurements. This includes contracts for drafting long-range plans and technical specifications that may form the basis for future contracts. Offices and personnel working on such contracts should be segregated from those who may bid on future procurements.

4. In responding to RFPs that call for the exercise of judgment, broadly defined, determine whether the contract may call on the firm to evaluate itself, its services, or its products. Next, ascertain whether the contract may require the firm to provide advice that may affect the firm's own economic interests. If either self-evaluation or providing potentially adverse (or beneficial) advice is required, consider whether a firewall can be constructed that would mitigate the potential conflict of interest.

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Endnotes

[1]—Aetna Gov't Health Plans, Inc., Comp Gen. Dec. B-254397, 95-2 CPD ¶129, at 12; see FAR 2.101, subpt. 9.5.
[2]—See, e.g., Nash, "Organizational Conflicts of Interest: An Increasing Problem," 20 Nash & Cibinic report ¶24 (May 2006); Gordon, "Organizational Conflicts of Interest: A Growing Integrity Challenge," 35 Pub. Cont. L.J. 25 (Fall 2005).
[3]—FAR 9.505.
[4]—Aetna Gov't Health Plans, Inc., Comp Gen. Dec. B-254397, 95-2 CPD ¶129.

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Organizational Conflicts of Interest (cont'd):

Endnotes (cont'd)

[5]—Id. At 12; see FAR 9.505, 9.505-4.
[6]—Aetna Gov't Health Plans, Inc., Comp Gen. Dec. B-254397, 95-2 CPD ¶129, at 13; see FAR 9.505-1, 9.505-2.
[7]—Aetna Gov't Health Plans, Inc., Comp Gen. Dec. B-254397, 95-2 CPD ¶129, at 13; see FAR 2.101, 9.505-3.
[8]—Madden, Pavlick, Worrall, "Organizational Conflicts of Interest/Edition III," Briefing Papers No. 94-8 (July 1994); Taylor, "Organizational Conflicts of Interest/Edition II," Briefing Papers No. 84-8 (Aug. 1984), 6 BPC 381; Pasley, "Organizational Conflicts of Interest," Briefing Papers No. 64-6 (Dec. 1964) , 1 BPC 97; see also Goddard, "Business Ethics in Government Contracting—Part I," Briefing Papers No. 03-6 (May 2003).
[9]—FAR 9.505.
[10]—FAR 9.504(a).
[11]—FAR 9.505.
[12]—FAR 9.507-1
[13]—See Madden, Pavlick, Worrall, supra note 8, at 9-10.
[14]—See FAR 9.508.
[15]—FAR 9.505(b).
[16]—Aetna Gov't Health Plans, Inc., Comp Gen. Dec. B-254397, 95-2 CPD ¶129, at 12 (emphasis added); see FAR 9.505, 9.505-4.
[17]—Snell Enters., Inc., Comp Gen. Dec. B-290113, 2002 CPD ¶115, at 8, 44 GC ¶305.
[18]—Mechanical Equip. Co., Comp. Gen. Dec. B-292789.2, 2004 CPD ¶192, at 25.
[19]—Johnson Controls World Servs., Inc., Comp. Gen. Dec. B-286714.2, 2001 CPD ¶20, 43 GC ¶76.
[20]—Id. At 5
[21]—Id. At 6
[22]—Id. At 6-7.
[23]—Id. At 7.
[24]—Mechanical Equip. Co., Comp. Gen. Dec. B-292789.2, 2004 CPD ¶192, at 25.
[25]—Id.
[26]—Id.
[27]—Id. at 26-27.
[28]—Id. at 27.
[29]—Id.
[30]—Id. at 28.
[31]—Id, at 29.
[32]—Id. at 25.
[33]—FAR 9.505-4(a).
[34]—FAR 9.505-4(a).
[35]—Snell Enters., Inc., Comp Gen. Dec. B-290113, 2002 CPD ¶115, at 8, 44 GC ¶305.
[36]—Id. at 6.
[37]—Johnson Controls World Servs., Inc., Comp. Gen. Dec. B-286714.2, 2001 CPD ¶20, 43 GC ¶76.
[38]—FAR 9.505-2(b)(1).
[39]—Aetna Gov't Health Plans, Inc., Comp Gen. Dec. B-254397, 95-2 CPD ¶129, at 13.
[40]—Id.
[41]—Lucent Techs. World Servs., Inc., Comp. Gen. Dec. B-295462, 2005 CPD ¶55, 47 GC ¶190.
[42]—Id. at 3.
[43]—Id. at 6.
[44]—See id. At 9-10.
[45]—SSR Eng'rs., Inc., Comp. Gen. Dec. B-282244, 99-2 CPD ¶27.

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Organizational Conflicts of Interest (cont'd):

Endnotes (cont'd)

[46]—Id. at 3.
[47]—Lucent Techs. World Servs., Inc., Comp. Gen. Dec. B-295462, 2005 CPD ¶55, 47 GC ¶190.
[48]—American Mgmt. Sys., Inc., Comp. Gen. Dec. B-285645, 2000 CPD ¶163.
[49]—Id.
[50]—Id. at 6.
[51]—Id. at 5.
[52]—Id. at 6.
[53]—See FAR 9.505-2(a)(3).
[54]—See Vantage Assocs., Inc. v. United States, 59 Fed. Cl. 1 (2003).
[55]—Id. At 11-12 (quoting FAR 9.505-2(a)(3)).
[56]—Id.
[57]—Id.
[58]—Id.
[59]—SSR Eng'rs., Inc., Comp. Gen. Dec. B-282244, 99-2 CPD ¶27.
[60]—Aetna Gov't Health Plans, Inc., Comp Gen. Dec. B-254397, 95-2 CPD ¶129, at 13.
[61]—Id.
[62]—PURVIS Sys., Inc., Comp. Gen. Dec. B-293807.3, 2004 CPD ¶177, 46 GC ¶362.
[63]—Id. at 8.
[64]—Id.
[65]—Id. at 9.
[66]—Computers Universal, Inc., Comp. Gen. Dec. B-292794, 2003 CPD ¶201, 45 GC ¶489.
[67]—Id. at 3.
[68]—FAR 9.505-3.
[69]—Aetna Gov't Health Plans, Inc., Comp Gen. Dec. B-254397, 95-2 CPD ¶129 (finding an organizational conflict of interest where the contract would require evaluation of an affiliate).
[70]—PURVIS Sys., Inc., Comp. Gen. Dec. B-293807.3, 2004 CPD ¶177, 46 GC ¶362.
[71]—Id. at 10-11.
[72]—Id. at 11.
[73]—Id.
[74]—LeBoef, Lamb, Greene & McRae, Comp. Gen. Dec. B-283825, 2000 CPD ¶35.
[75]—Id. at 7.
[76]—Id. at 8-10.
[77]—Alion Science & Tech Corp., Comp. Gen. Dec. B-297022.3, 2006 CPD ¶2.
[78]—Id. at 6.
[79]—Id. at 9.
[80]—Id. at 11.
[81]—Id.
[82]—Science Applications Int'l Corp., Comp. Gen. Dec. B-293601, 2004 CPD ¶96, 46 GC ¶224.
[83]—Id. at 2
[84]—Id. at 4.
[85]—Id. at 5.
[86]—Id. at 7-8.
[87]—Alion Science & Tech Corp., Comp. Gen. Dec. B-297022.3, 2006 CPD ¶2, at 12.

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even if the business is discontinuing the product. Other agencies such as the Departments of Energy (DOE), Agriculture, Transportation, and Health and Human Services are authorized to place priority ratings on certain programs for the "national defense" in consultation with the Department of Commerce.[8]

The Government used "rated" orders recently in support of Operation Desert Shield and Desert Storm, the Balkans,[9] and in Operation Enduring Freedom, and Iraqi Freedom, as well as in the Balkans,[9] to assist the warfighter. For the war in Afghanistan, rated contracts were used for obtaining components for "smart bomb" munitions, targeting and sensor equipment for the unmanned aerial vehicles, and ballistic material for body armor. After September 11, rated orders were used to upgrade the FBI communications and data processing, to help the Transportation Security Administration obtain timely delivery of explosive detection equipment and to upgrade airport security data processing, and to help the Department of Homeland Security (DHS) enhance port security.[10] It is likely that rated orders will continue to be used for military purchases relating to the Global War on Terror and for homeland defense.

The Defense Production Act also has a role in disaster relief. In 1994, Congress authorized FEMA to use the Defense Production Act for "emergency preparedness activities" conducted under the Stafford Act.[11] "Emergency preparedness activities" include measures before, during, and after a disaster.[12] In the aftermath of a hurricane or other disaster, they would include such activities as fire fighting, rescue operations, medical services, and debris clearance.[13] In response to Katrina, the Department of Commerce authorized FEMA and the DHS to use the DPAS for recovery operations. The authority extended to "activities for rescue, emergency medical, health and sanitation services, essential debris clearance, and immediately essential repair or restoration of damaged vital facilities."[14] The Department of Commerce's website states that it intended to use the DPAS to purchase items such as temporary housing and plastic sheeting.[15] According to FEMA and DHS officials, however, the Government used the DPAS sparingly, if at all, in response to Hurricane Katrina.

The priorities system also has a place in the new age of fighting terrorism. In 2003, Congress expanded the use of the Defense Production Act to apply to "critical infrastructure protection and restoration."[16] "Critical infrastructure" is an amorphous term, but the Defense Production Act gives it a sweeping scope, defining it as:

> any systems and assets, physical or cyber-based, so vital to the United States that the degradation or destruction of such systems and assets would have a debilitating impact on national security, including but not limited to, national economic security and national public health or safety.[17]

The term has commonly been used to refer to computer and communication networks and the like, but it also includes water supplies, power production, electrical transmission and distribution, emergency services, banking systems, mass transit systems, or gas and oil production.[18] The DHS, in its daily review of threats to infrastructure, includes energy production, chemical plants, banking and finance, postal and shipping services, agriculture, water supplies, Internet and information technology, and national monuments in the category of critical infrastructure.[19] The Gulf Coast, where Hurricane Katrina hit, was replete with these types of systems, and it is arguable that the loss or damage to bridges, hospitals, oil refineries, telephone networks, government buildings and other assets in the Gulf Coast had a "debilitating impact" on national economic security and public health and safety.

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Implementing the Defense Production Act (cont'd):

The President, in the December 17, 2003, Homeland Security Presidential Directive/HSPD-7, directed the Department of Commerce to work with the private sector and other government organizations to promote critical infrastructure efforts, "including using its authority under the Defense Production Act to assure the timely availability of industrial products, materials, and services to meet the homeland security requirements."[20] Two and a half years later, as Hurricane Katrina hit New Orleans and the Gulf Coast, neither the Department of Commerce nor DHS had developed any guidance on how the Defense Production Act could be used in relation to critical infrastructure. On July 13, 2006, almost a year after Hurricane Katrina, the Bureau of Industry and Security of the Department of Commerce published a final rule (without the opportunity for comment) amending the DPAS to include "critical infrastructure protection and restoration" and "emergency preparedness activities" in the definition of "national defense."[21]

III. Statutory Background of the Priorities and Allocation System

The DPAS is based on three main statutory provisions: (1) the priorities and allocations provisions of the Defense Production Act of 1950;[22] (2) the priorities provisions of Section 18 of the Selective Service Act of 1948;[23] and (3) the civil service preparedness provisions of Section 602 of the Stafford Act.[24] The main authority for the DPAS originates from the Defense Production Act and has traditionally applied to matters of "national defense."[25] The Government, namely FEMA, also is allowed to use the Priorities and Allocations System for emergency preparedness and recovery under the Stafford Act, which usually applies to a "natural disaster" or "an accidental or man-caused event."[26] The Selective Service Act provides the President with some of the same types of authority as found under the Defense Production Act but on a more limited basis.[27] The Selective Service Act provisions are used only when the Defense Production Act is allowed to expire.[28]

Pursuant to Title I of the Defense Production Act,[29] the President has the authority to require contractors to put priorities on the performance of their government contracts over other contracts.[30] Moreover, it gives the President the authority to require any person capable of meeting the Government's needs -- whether or not that person is a Government contractor -- to accept and perform contracts for the United States. Section 2071 reads:

> The President is authorized (1) to require that performance under contracts or orders (other than contracts of employment) which he deems necessary or appropriate to *promote the national defense* shall take priority over performance under any other contract or order, and for the purpose of assuring such priority, to require acceptance and performance of such contracts or orders in preference to other contracts or orders by any person he finds to be capable of their performance, and (2) to allocate materials, services, and facilities, in such a manner, upon such conditions, and to such extent as he shall deem necessary or appropriate to *promote the national defense*.[31]

When the Act was first passed in 1950, the Congress justified its existence with the present international situation that required "some diversion of certain materials and facilities from civilian use to military and related purposes."[32] Before the Act, the Government had relied on judicially created doctrine that had enforced the Government's ability to make companies comply with its military priorities.[33] Accordingly, the statute and its history have relied heavily on a "national defense" justification.

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Implementing the Defense Production Act (cont'd):

While the "present international situation" may have changed since 1950, the needs are still familiar. In order to provide for the national defense, the original Defense Production Act acknowledged the need for "diversion of certain materials and facilities from civilian use to military and related purposes [and the] expansion of productive facilities beyond the levels needed to meet the civilian demand."[34] The Defense Production Act was originally set to expire in 1951,[35] but, over the years, it has been extended on a periodic basis by Congress, usually for a year or two at a time.[36] The Defense Production Act actually expired in 1990 during the buildup to Desert Storm but was reauthorized soon thereafter.[37] In the quiet summer of 2001, Congress again took up the idea of extending the Defense Production Act that was set to expire on September 30, 2001.

While the reauthorization of the Act was usually non-controversial, the Act saw some heightened scrutiny in 2001 -- not from any fear of then-unexpected terrorist attacks, but from concern that President Clinton had improperly authorized the DOE to use the Act in early 2001 to assist in resolving the California energy crisis. As explained more fully in this article, the DOE issued rated orders under the Defense Production Act to natural gas suppliers, requiring them to make sales to a near-bankrupt California power company to keep California's power running. Because he was so upset with using the Defense Production Act to alter market forces, Sen. Phil Gramm called the Act "the most powerful and potentially dangerous American law…."[38] Hearings were held in 2001 during the calm before the storm of September 11, but Congress shelved all of those issues after the attacks and passed the reauthorization of the Act without further discussion for another two-year term.[39] On December 19, 2003, the President again reauthorized the Defense Production Act through the Defense Production Act Reauthorization of 2003.[40] This time the Congress reauthorized the Act for 5 years, through September 2008.[41]

IV. Expansion of the DPAS to Critical Infrastructure Protection

The Defense Production Act's reauthorization in 2003 may have been more significant than simply its five-year term. Congress made clear in 2003 that the Federal Government could use the Defense Production Act not only for traditional "national defense" purposes or for emergency preparedness and recovery but also for protecting certain non-defense systems designated as "critical infrastructure."[42] While the full impact of this change is still not clear, it is certainly a development that private industry as well as states, localities, and tribal entities should understand. Over the past few years, "critical infrastructure" has been used to refer to assets and systems that might not be considered items of national defense, but are nonetheless so important that their destruction would have a "debilitating impact" on the economic security or defense of the United States.[43] The term has commonly been used to refer to computer and communication networks and the like, but it also includes water supplies, power production, electrical transmission and distribution, emergency services, banking systems, mass transit systems, emergency services, or gas and oil production.[44] A substantial amount of critical infrastructure is owned by private business or operated by states and localities. While these items are important, they are not necessarily considered vital to the "national defense" and therefore were not arguably within the scope of the DPA as it existed before 2003.

In fact, in 1997, the President's Commission on Critical Infrastructure Protection recommended that the Federal Government should look closely at amending the Defense Production Act to protect critical infrastructure of the United States.[45] The President's Commission recommended in its report that the Defense Production Act's Declaration of Policy should be amended to "include a finding that critical infrastructures are essential to national security."[46]

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Implementing the Defense Production Act (cont'd):

Between 1997 and 2001, there seemed to be little interest in expanding the DPAS to cover critical infrastructure. After September 11, however, the concern about "critical infrastructure" was heightened. At first, however Congress took no direct action to apply the Defense Production Act to protecting or rebuilding such critical infrastructure systems if a terrorist act occurred.

In October 2001, Congress passed the Critical Infrastructures Protection Act of 2001 (CIP Act) as part of the United and Strengthening America by providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA PATRIOT Act).[47] The Critical Infrastructure Protection Act defines "critical infrastructure" as

> systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems and assets would have a debilitating impact on security, national economic security, national public health or safety, or any combination of those matters.[48]

Accordingly, while recognizing its importance, Congress stopped short of specifically tying "critical infrastructure" to "national defense." The CIP Act provided funding for gathering information about critical infrastructure and the development of "modeling and analytical capabilities" to make policy recommendations on protection of such infrastructure, but it did not directly deal with protection.[49]

In the Homeland Security Act of 2002, Congress encouraged the private sector, states, and localities to share "critical infrastructure information" with the DHS so that the Government could develop protection plans.[50] The definition of "critical infrastructure" for the purpose of the DHS Critical Infrastructure Information regulations borrows the PATRIOT Act's definition.[51] Accordingly, the changes still did not specifically allow the Department of Commerce to use the DPAS to apply rated orders to federal, state or privately-run projects to protect "critical infrastructure" because the Defense Production Act only applied to "national defense."

In 2003, Congress finally made a solid connection between "critical infrastructure" and the Defense Production Act. In reauthorizing the Defense Production Act, Congress changed the definition of "national defense" to include coverage of critical infrastructure.[52] The Senate Committee on Banking, Housing, and Urban Affairs expressed concern for protecting systems from terrorists. It noted that since the various attacks around the world and the September 11 attacks, "there has been increasing focus on the vulnerability of this nation's telecommunications systems, power grids, food and water supplies, and other elements of what is referred to as the nation's critical infrastructure."[53] During hearings in June 2003, the Committee debated whether the Defense Production Act needed to be amended to ensure that critical infrastructure could be protected under its authority. The Committee concluded that even though it believed that the Act already provided the Government with the implicit ability to protect "critical infrastructure," it was important to include specific, explicit language to that effect in the Act.[54]

Accordingly, as passed, the Defense Production Act now specifically allows the Departments of Commerce and Homeland Security to use the priorities and allocations systems to protect "critical infrastructure."[55] That term is defined as

> any systems and assets, physical or cyber-based, so vital to the United States that the degradation or destruction of such systems and assets would have a debilitating impact on national security, including but not limited to, national economic security and national public health or safety.[56]

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Implementing the Defense Production Act (cont'd):

A. The "Most Dangerous Law In America"?

Expanding the coverage of the Act could be viewed as a far cry from where Congress appeared to be in early 2001. Indeed, just two years before, some in Congress saw the Defense Production Act's intrusion into nondefense matters as a threat to free market economies. Some in the Congress, specifically former economics professor Senator Phil Gramm, had been critical of the manner that the Clinton Administration had used the Defense Production Act to deal with the California energy crisis.

In 2000, the California regulated electric utilities, namely Pacific Gas & Electric Company (PG&E), were suffering huge debts, placing them on the edge of insolvency. Logically, PG&E's suppliers were unwilling to make sales of natural gas to the near-bankrupt-PG&E, which threatened the state with a loss of electrical supply. The state took several actions to maintain power service and requested help from the Federal Government. In late 2000 and early 2001, the DOE invoked its emergency powers under the Natural Gas Policy Act of 1978, as well as the Defense Production Act of 1950, to save California from a potential electrical disaster. Under the Natural Gas Policy Act, the DOE had the authority to make PG&E continue serving its customers, but had no authority to make PG&E's suppliers continue to sell gas to PG&E at a reasonable price. The DOE used the Defense Production Act's priority and allocations provisions to impose a "temporary supply assurance" on PG&E's suppliers that required them to sell gas to PG&E.[57]

When the Defense Production Act came up for reauthorization in early 2001, Senator Gramm was so incensed by the Energy Department's actions in California that he called the Defense Production Act the "most powerful and potentially dangerous American law."[58] Not surprisingly, Senator Gramm and others questioned whether the protection of the California electrical supply fit under the scope of "national defense" issues covered by the Defense Production Act.

Senator Gramm's objections obviously faded in 2003 after he retired and when the interest of protecting the nation against terrorism became a first priority. A few in Congress still had concerns over the intervention of the Government into the market. Rep. Ron Paul (R-TX) thought that the reauthorization gave the President "almost unchecked power … to interfere in the economy in the name of "national security."[59] Senator Gramm's and Representative Paul's concerns were overcome by other arguments, but there are still questions of how the Defense Production Act correlates with a market economy. Is it truly necessary for the Federal Government to allow private industry to impose ratings and price controls on other private entities to help protect private infrastructure? Does the application of the Defense Production Act undermine the idea that markets will work to protect infrastructure that is worthy of protection? Are there other solutions that would impose incentives on businesses protect or restore facilities? When Congress considers reauthorizing the Defense Production Act in 2008, it will certainly need to review whether the DPAS is or can be used effectively to protect critical infrastructure.

B. How Will The DPAS Work with Critical Infrastructure?

In the end, whether the coverage of infrastructure protection under the Defense Production Act makes sense is a moot issue for now, at least until the Act expires in 2008. In a Homeland Security Presidential Directive/HSPD-7 entitled "Critical Infrastructure Identification, Prioritization, and Protection," issued on December 17, 2003, the President authorized the Department of Commerce to work with the DHS, the private sector, and other entities to "promote other infrastructure efforts, including using its authority under the Defense Production Act to assure the timely availability of industrial products, materials,

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Implementing the Defense Production Act (cont'd):

and services to meet homeland security requirements."[60]

In 2006, the Department of Homeland Security published the National Infrastructure Protection Plan (NIPP).[61] The NIPP provides overall guidance on the protection of Critical Infrastructure/Key Resources (CI/KR), but it provides only scant guidance as to how the DPAS would be used with regard to critical infrastructure protection and restoration. Pursuant to the NIPP, DHS maintains the National Assets Database (NADB), which includes an inventory of critical infrastructure and the "physical, cyber, and human elements of each asset."[62] The only reference to the use of the Defense Production Act in the NIPP is provided in a summary of relevant statutes. In that section, the NIPP summarizes the general role of the DPA and DPA in emergency preparedness and critical infrastructure protection:

> This act defines "national defense" to include critical infrastructure protection and restoration, as well as activities authorized by the emergency preparedness sections of the Stafford Act. Consequently, the authorities stemming from the Defense Production Act are available for activities and measures undertaking in preparation for, during, or following a natural disaster or accidental or malicious event. Under the act and related Presidential orders, the Secretary of Homeland Security has the authority to place and, upon application, authorize State and local governments to place priority-rated contracts in support of Federal, State, and local emergency preparedness activities. The Defense Production Act has a national security nexus with the NIPP. National emergencies related to CI/KR may arise that require the President to use his authority under the Defense Production Act.[63]

The Department of Commerce likewise took more than two years to provide guidance on the use of the DPAS with "critical infrastructure." As a result of amendments to the DPAS regulations published by the Department of Commerce in July 2006, the DPAS now includes "Critical Infrastructure Protection and Restoration" as an approved program identified by DHS for a DO priority rating.[64]

Also, in response to the criticism following Hurricane Katrina, the FAR Council proposed to consolidate all of the emergency procurement regulations in one section of the FAR — FAR part 18 — for ease of use by contracting officers. This interim rule recognizes that emergency procurement authority is not limited to natural disasters and could be needed before or after an emergency declaration is declared.[66] The new section of the FAR reminds contracting officers that the DPAS applies in the case of a "national emergency."[67] The new section does not, however, note that the DPAS applies to critical infrastructure.

Federal regulations still fail to provide clear guidance to states, localities, or private industry on how to implement the DPAS for a particular situation involving critical infrastructure. Other agencies, such as the Department of Energy, could be used as a guide. The Department of Energy is authorized to use the DPAS system to meet the requirement of 50 U.S.C. App. § 2071(c) for supplies and equipment to "maximize domestic energy supplies."[68] The DOE may use the system upon a finding that materials are "scarce, critical, and essential" to the "exploration, production, refining, transportation, . . . " [or] the conservation of energy supplies" or the "construction and maintenance of energy facilities." DOE's regulations allow for persons (including businesses and federal and state agencies) to submit applications to DOE for coverage under the DPAS if those persons "believe that they perform work associated with a program or project which may qualify as an eligible energy program or project" that needs assistance under the DPAS.[70]

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Implementing the Defense Production Act (cont'd):

V. How the Defense Priorities and Allocations System Works

A. Contractors Must Give Rated Orders Preferential Scheduling

At the heart of the Defense production Act and the DPAS is the issuance of an order with a priority rating from the Federal Government or one of its contractors. Pursuant to Title I of the Defense Production Act, the President has the authority to require contractors to put priorities on the performance of their government contracts over other contracts.[71] Moreover, it gives the President the authority to require any person capable of meeting the Government's needs -- whether or not that person is a government contractor -- to accept and perform contracts for the United States. Section 2071 reads:

> The President is authorized (1) to require that performance under contracts or orders (other than contracts of employment) which he deems necessary or appropriate to *promote the national defense* shall take priority over performance under any other contract or order, and for the purpose of assuring such priority, to require acceptance and performance of such contracts or orders in preference to other contracts or orders by any person he finds to be capable of their performance, and (2) to allocate materials, services, and facilities, in such a manner, upon such conditions, and to such extent as he shall deem necessary or appropriate to *promote the national defense*.[72]

The Government may rate an order as a "DX" or "DO" rated order. "DX" rated contracts are the highest rated and take precedence over "DO" rated contracts and other unrated contracts.[73] "DO" rated contracts take precedence over any other unrated contract.[74]

Businesses receiving rated orders must "schedule operations, including the acquisition of all needed production items, in a timely manner to satisfy the delivery requirements of each rated order."[75] Rated orders "must be given production preference over unrated orders, if necessary to meet required delivery dates, even if this requires the diversion of items being processed or ready for deliver against unrated (or lower rated) orders."[76]

In some instances where a contractor has several rated orders to fill, there are often questions of which order takes priority when changes occur. If changes are made to a rated order which "significantly alter[] a supplier's original production or delivery schedule," the changes shall constitute a newly rated order as of the receipt date.[77] This would then place the priority of the order behind other equally rated orders received before the changes. However, some changes will not create a newly rated order. Those are a "change in shipping destination, a reduction in the total amount of the order; an increase in the total amount of the order which has negligible impact upon deliveries; a minor variation in size or design; or a change which is agreed upon between the supplier and the customer."[78]

B. Businesses Must Use Inventory to Meet Delivery

If a business cannot meet a rated order delivery date by purchasing production items, then it must use inventory to meet the deadline.[79] It can replace the inventory by using a rated order.[80] Accordingly, a business is obligated to use products in stock to meet a rated order even though those products were destined for other contracts.

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Implementing the Defense Production Act (cont'd):

C. Government Can Require Acceptance of Rated Order For Older Products

A supplier can be required to accept a rated order for any products that have been sold in the last two years before the order, up to the amount sold in the last two years.[81] For example, if the supplier has a product that it had stopped producing three years ago, but it sold thirty of them in the last year, the supplier could be required to produce and fill a rated order for thirty of the items.

D. Agencies and Contractors Can Issue Rated Orders to Anyone

Even though a company may have never contemplated doing work for the Government, that does not prevent the Government from issuing an order under the DPAS. The Defense Production Act gives the President the authority to require "any person he finds to be capable of … performance" to accept an order.[82] Accordingly, the DPAS system allows a federal agency or federal contractor to issue an order to any business whether or not there has been a prior relationship. The company must fulfill the request unless it has a valid reason for rejecting it.[83] In the 1960's, the Government issued rated orders to several companies for the production of Agent Orange and it compelled one company to produce even though it objected.[84]

E. Businesses Can Reject Orders But Must Do So Promptly

Businesses must accept rated order unless they meet the test for mandatory or optional rejection under 15 C.F.R. § 700.13.[85] For example, a supplier must reject the order if it knows that it cannot meet the delivery requirement or if acceptance of the order would interfere with the timely delivery of an earlier accepted DX rated order.[86] The business may reject the order if the buyer is "unwilling or unable to meet the regularly established terms of sale or payment."[87] The regulations require a company to reject the order in writing within fifteen working days of receipt for DO order and ten working days of receipt for DX orders.[88] In March 2005, the Department of Commerce amended the regulations to allow companies to reject the order in electronic format as well as in writing (hard copy).[89]

F. Suppliers Are Protected from Claims on Other Contracts

The DPAS also protects a company that receives a rated order from being subject to a claim of breach on its other contractual obligations. If the rated order is proper, a contractor is protected from lawsuits from its other customers by an "exculpatory" provision in the Act that protects contractors from claims arising from fulfilling orders under the system. Section 707 of the Defense Production Act reads:

> No person shall be held liable for damages or penalties for any act resulting directly or indirectly from compliance with a rule, regulation, or order issued pursuant to this Act notwithstanding any rule, regulation, or order shall thereafter be declared by judicial or other competent authority to be invalid. No person shall discriminate against orders or contracts to which priority is assigned or for which material or facilities are allocated under title I of this Act or under any rule, regulation, or order issued thereunder, by charging higher prices or by imposing different terms and conditions for such orders or contracts than for other generally comparable orders or contracts, or in any other manner.[90]

For instance, a contractor may be entitled to a time extension on one of its contracts if the fulfillment of a higher priority rated order causes delays.[91] The contractor must show, however, that the priority system in fact caused the delay.[92]

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Implementing the Defense Production Act (cont'd):

The system can also protect the contractor from lawsuits from commercial customers. In fulfilling a rated order, a contractor may fall behind on fulfilling its orders to other agencies or commercial clients because it had to put its rated government work higher on its list of priorities. The contractor will be protected from an action for delay damages or breach of contract by the exculpatory provision and 15 C.F.R. § 700.90, which states "a person shall not be held liable for damages or penalties for any act or failure to act resulting directly or indirectly from compliance" with the DPAS. In *Eastern Airlines, Inc. v. McDonnell Douglas*, McDonnell Douglas successfully defended a breach of contract claim that it had failed to deliver jets on time to Eastern on the basis that its delay was excused because it had to fulfill the Government's orders first.[93]

The exculpatory provision does not protect a contractor from every risk. Contractors have also attempted to avoid other liabilities based on the operation of the "exculpatory" provision of the Act, but with less success. In *United States v. General Dynamics Corp.*, General Dynamics attempted to argue that it was immune from civil penalties arising from violations of the Clean Air Act because its rated order contract provided it with immunity for any liability arising from performance of a rated order.[94] The district court rejected this argument as an overbroad reading of the liability protections of the Defense Production Act, noting that there was no indication from Congress that it intended to allow defense contractors to violate the Clean Air Act "with impunity, as long as the defense contractors were attempting to fulfill and comply with their respective government contracts."[95]

The operation of the Defense Production Act has also raised arguments in the past as to whether the Government becomes liable for the contractor's actions. In litigation relating to the production of Agent

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Aspects of Construction Scheduling (cont'd from page 18):

Endnotes (cont'd)

[29]—Andrew D. Ness, *Delay, Suspension of Work, and Acceleration* in Fed. Gov't Construction Cont. (2003). A total time or modified total time approach may still prevail where it appropriately takes into account the factors that have been established for use of the total cost or modified total cost approaches with regard to delay and concurrent delay. *See Hardrives, Inc*., IBCA Nos. 2319/2514, 2375/2475, 2414/2515, 2510, 2511, 2516, 2518, 2519, 2524, 94-1 BCA ¶26267 at 130,683 (citing *Norair Eng'g. Corp*., ENG BCA Nos. 3804, 3823, 4075, 4105, 4135, 4202, 4379, 4559, 4579, 90-1 BCA 22,327 at 112,209).
[30]—*John Driggs Co*., ENG BCA Nos. 4926, 5061, 5081, 87-2 BCA ¶19,833 at 10,388; *see also Hardrives,* 94-1 BCA at 130,683-84.
[31]—*Utley James, Inc*., 85-1 BCA ¶17,816; *MCI Constructors, Inc*., DCCAB No. D-924, 1996 DCBCA Lexis 71 (June 4, 1996); *Bechtel Environmental, Inc*., ENG BCA Nos. 6137, 6166 97-1 BCA ¶28,640.

Implementing the Defense Production Act (cont'd):

Orange, the manufacturers argued that the United States should have "arranger liability" under Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) arising out of the Defense Production Act.[96] Hercules argued that the Government was intimately involved in the production of Agent Orange through the use and implementation of the rated orders, thereby making it a person who "arranged for disposal" of hazardous material.[97] The court rejected the argument by stating that the Defense Production Act did not alter the relationship between the Government and the manufacturer into anything but one between a buyer and seller, "except that the buyer (i.e., the United States) has the power to require the seller to perform the contract and to give it priority over other contracts.'" [98]

Likewise, the Supreme Court held that the operation of the Defense Production Act — along with the imposition of detailed specifications, superior knowledge, and threat of criminal and civil penalties — did not create an implied-in-fact contract for the Government to indemnify the manufacturers of Agent Orange for defending lawsuits of third parties.[99] The Court determined that such an open-ended indemnity agreement would violate the Anti-Deficiency Act and would therefore be illegal. In any event, the Court held that the Defense Production Act promises "immunity, not indemnity" from liabilities flowing from filling a rated order.[100]

G. Priorities Apply to Subcontractors and Suppliers

The priorities, where properly invoked, apply to all suppliers and subcontractors on affected prime contracts. It is the responsibility of the prime and its subcontractors at every level below it to ensure that they implement the priorities system properly. Businesses receiving rated orders from the Government are required to place rated orders with suppliers and subcontractors to meet rated order delivery dates.[101] The failure to do so will make the contractor liable for any delays or problems that arise with delivery.[102]

Moreover, it is the prime contractor's duty to make sure that its subcontractors are fully aware of the DPAS and their obligations under the system. For instance, a contractor's argument that the government representatives should have advised it and its subcontractors of the critical nature of the contract deliverables failed as an excuse to defend a default termination of the prime. The board found that "the prime contractor . . . not the Navy, was responsible for ensuring that its subcontractors met the contract completion date, including appropriate utilization of the defense priorities rating system . . . ."[103]

H. Orders Must Meet Certain Requirements to Be Valid

In order for an order to be a valid rated order under the DPAS, it must include certain elements. First, the order must have the appropriate priority rating (DX or DO) and a program identification symbol.[104] The program identification symbols are listed in Schedule I to 15 C.F.R. Part 700.[105] FEMA orders for emergency preparedness will be identified by the program identification symbol "N1."[106] The identification mark for "critical infrastructure" projects is "N7."[107]

Second, the order must specify a required delivery date.[108] Using the words "as soon as possible" is not sufficient. The Armed Services Board of Contract Appeals has held in at least one case that businesses must clearly specify a delivery date in placing a rated order with subcontractors and suppliers.[109]

Third, the order must contain a written signature or a digital signature (on an electronically placed order).[110]

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Implementing the Defense Production Act (cont'd):

Fourth, under the current regulations, the order must include a statement that reads:

> This is a rated order certified for national defense use, and you are required to follow all the provisions of the Defense Priorities and Allocations System regulation.[111]

In September 2004, the General Services Administration (GSA) issued new regulations governing its Federal Supply Schedule (FSS) contracts that provide its contracting officers with guidance on placing rated orders under the FSS.[112] The regulations do not create new obligations for contractors, but they highlight some of the procedures for contracting officers. For instance, they remind GSA contracting officers that they may place ratings on an entire contract at the time of award or on an individual order issued under an "existing, otherwise unrated, contract."[113] Multiple and single award schedule (MAS) contracts will not be rated at the time of award, but an agency can issue rated orders under those contracts.[114]

I. Agencies and Businesses Can Seek Special Priorities Assistance from the Commerce Department

Prime contractors may find themselves in difficult situations with a subcontractor who has been issued a rated order and then refuses or is unable to fulfill the requirement. Where the subcontractor fails to deliver or rejects the rated order, the prime should seek special priority assistance from the contracting officer by submitting a form BIS-99 as soon as possible to avoid civil and criminal sanctions and to ensure that the contractor has a defense against delays that might arise because of the problem. The process for obtaining assistance is set forth at 15 C.F.R. § 700.50-55. Under the DPAS, the agency will attempt to assist the contractor in resolving the situation, but, if the agency cannot resolve it, it can forward the request to the Department of Commerce for action.[115]

The Federal Acquisition Regulation (FAR) requires all contractors and subcontractors at any tier to "promptly seek priorities assistance" whenever they have difficulty placing rated orders or obtaining timely delivery on rated orders, making sure that rated orders receive appropriate preferential treatment, etc.[116] For FEMA-related emergency preparedness programs, the agency or contractor can seek priorities assistance for obtaining common use items if there are threats to timely delivery.[117] Some contractors have found out the hard way that they should seek government priorities assistance sooner rather than later.[118]

J. The Government Can Enforce DPAS Orders

The President also has certain powers to ensure that companies comply with the DPAS. The most immediate is the looming threat of criminal penalties for willful refusals to comply with the Defense Production Act or the DPAS regulations. Pursuant to Section 705(c) of the Act, a willful violation of the Act is punishable by a fine of $10,000, one year in prison or both.[119] Criminal sanctions have rarely, if ever, been used. But, there are also other avenues of enforcement. The Defense Production Act provides the President with the authority to seek an injunction in federal district court requiring a person or company to comply with a rated order.[120]

VI. Conclusion

The unfortunate devastation of Hurricane Katrina unfortunately taught the United States several lessons that were not evident from previous disasters, or even from September 11. There are some disasters that will test the abilities of the government, states, and localities to respond effectively. Hurricane Katrina also tested the willingness of companies to volunteer to assist in emergency recovery.

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Implementing the Defense Production Act (cont'd):

Accordingly, in the future, the ability of the Government to use the DPAS to engage companies for emergency contracting may become more important.

Secondly, Hurricane Katrina showed that, whether by natural forces or by terrorism, a strike to an industrial location, like the Gulf Coast, that supplies fuel or goods to the rest of the nation could create as much of an economic impact as hitting the nation's major financial centers, like Wall Street. Both of these areas contain critical infrastructure that is vital to the well-being of the country. Protecting and ensuring the rapid restoration of critical infrastructure in the case of another major natural disaster or terrorist attack must be addressed effectively. The DPAS may provide some help to public and private infrastructure owners.

The benefits of the Defense Production Act for responding to emergencies or protecting or rebuilding critical infrastructure may be debatable, but it serves no good if it is never used. The Department of Commerce and the DHS have taken some steps in the last few years to make better use of the DPAS for disaster relief and protection of critical infrastructure. However, there is much more that probably should be done, especially as the DPAS relates to critical infrastructure protection. In order for the DPAS to be used efficiently for critical infrastructure, it is vital that there be a clearly-defined, well-publicized process whereby federal and nonfederal owners of critical infrastructure understand the availability of the DPAS to protect and restore their systems and can apply to use the priorities system for that purpose.

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Endnotes

[1]– Disaster Relief Act of 1974, Pub. L. No. 93-288, 88 Stat. 143 (codified as amended at 42 U.S.C. §§5121-5206 (2000)); Disaster Relief and Emergency Assistance Amendments of 1988, Pub. L. No. 100-707, 102 Stat. 4689 (amending the 1974 Act short title to "The Robert T. Stafford Disaster Relief and Emergency Assistance Act").

[2]– Homeland Security Act of 2002, Pub. L. No. 107-296, 116 Stat. 2135 (codified as amended at 6 U.S.C. §§317-557 (Supp. 2002)).

[3]– House Select Bipartisan Committee to Investigate the Preparation for & Response to Hurricane Katrina, A Failure of Initiative: Final Report of the Select Bipartisan Committee to Investigate the Preparation for and Response to Hurricane Katrina, H.R. Rep. 109-377, at 337 (2006).

[4]– 50 U.S.C. app. §§2061-2170(2000).

[5]– 15 C.F.R. pt. 700 (2006).

[6]– Pub. L. No. 1031-1337 (codified at 50 U.S.C. app. 2152(14)).

[7]– Pub. L. No. 108-195, §5(1) (codified at 50 U.S.C. app. 2152(14)).

[8]– Exec. Order No. 12,919, 59 Fed. Reg. 29,525 (June 3, 1994).

[9]–*Reauthorization of the Defense Production Act: Hearing before the Senate Comm. on Banking, Housing and Urban Affairs,* 108th Cong. 34 (2003) statement of Karen H. Bhatia, Deputy Under Secretary for Industry and Security, Department of Commerce); *see also Reauthorization of the Defense Production Act of 1950: Hearing before the Subcomm. on Domestic Monetary Policy, Technology and Economic Growth of the House Comm. on Financial Services,* 107th Cong. 14 (2001) (statement of Hon. David R. Oliver, Jr., Principal Deputy Under Secretary for Acquisition, Technology and Logistics, Department of Defense) ("But what I would like to share with you is the Kosovo incident. When we needed to reprioritize some suppliers for various precision weapons, and it was really important to do so, the Act enabled me to get the contractors' attention. Without that authority, we might have been able to work it out, but it was much more effective to have their attention right from the beginning.")

[10]- *Reauthorization of the Defense Production Act, supra,* note 8, at 34 (statement of Karen H. Bhatia, Deputy Under Secretary for Industry and Security, Department of Commerce).

[11]– *See* 42 U.S.C. §5195a(b) (2000).

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Implementing the Defense Production Act (cont'd):

Endnotes (cont'd)

[12]-*Id*. §5195a(a)(3).
[13]– *Id.*
[14]– U.S. Bureau of Industry and Security, Department of Commerce Support to Hurricane Relief Operations, http://www.bis.doc.gov/DefenseIndustrialBasePrograms/OSIES/DPAS/Hurricane.htm (last visited Aug. 4, 2006).
[15]– Department of Commerce, Department of Commerce Relief Efforts, http://www.commerce.gov/Katrina_Commerce_Efforts.htm (last visited Sept. 1, 2006).
[16]– *See* 50 U.S.C. app. §2152(14) (2000).
[17]– *Id*. §2152(3).
[18]– *See* John Moteff et al., Cong. Research Serv., Critical Infrastructure: What Makes Infrastructure Critical? 2 (2003).
[19]– *See, e.g.,* U.S. Dep't of Homeland Sec., Department of Homeland Security Daily Open Source Infrastructure Report for 04 August 2006 1 (2006), http://www.dhs.gov/interweb/assetlibrary/DHS_Daily_Report_2006-08-04.pdf.
[20]– Homeland Security Presidential Directive/HSPD-7 on Critical Infrastructure Identification, Prioritization, and Protection, 39 Weekly Comp. Pres. Doc. 1818, at ¶22 (Dec. 17, 2003), available at http://www.whitehouse.gov/news/releases/2003/12/print/2003 1217-5.html.
[21]– Defense Priorities and Allocations System (DPAS): Administrative and Technical Corrections, 71 Fed. Reg. 39,526, 39,527 (July 13, 2006) (to be codified at 15 C.F.R. 700.1(c)).
[22]– *See* 50 U.S.C. app. §§2061-2071 (2000).
[23]—*Id*. §468 (2000).
[24]—*See* The Robert T. Stafford Disaster Relief and Emergency Assistance Act, 42 U.S.C. §5195a (2000).
[25]—*See* 50 U.S.C. app.§2071.
[26]—42 U.S.C. § 5195a. In 1994, Congress authorized FEMA to use the DPAS pursuant to language in the Defense Production Act noting that emergency preparedness activities conducted under the Stafford Act qualify as "national defense" or "defense" acts of the Defense Production Act.
[27]–For instance, while the Utilization of Industry provisions of the Selective Service Act provides the President with authority to place orders with "any person operating a plant, mine, or other facility capable of producing such articles or materials" in a quantity that the President deems appropriate, that power is limited to purchases for the benefit of the armed forces. 50 U.S.C. App. § 468. The Act also provides the President with the ability to place a rating on an order, but it does not protect a business from claims arising from complying with a rated order as the Defense Production Act does. The Selective Service Act also does not provide the federal government with the explicit power to obtain an injunction in a United States District Court against a person who fails to comply with a rated order as is provided under the Defense Production Act. 50 U.S.C. App. § 2156. In a few aspects, the Selective Service Act is more powerful than the Defense Production Act. It gives the President the authority to take over a facility or plant to produce the needed articles if the owner refuses comply with the Act. 50 U.S.C. App. § 468(c). Of course, the Government must provide "fair and just compensation" to any person for articles furnished to the government under an order or for the value of the rental of any facility of which the government takes possession. 50 U.S.C. App. § 468(d). The penalties for violation of the Selective Service Act are also more severe than those imposed by the Defense Production Act. Under the SSA, a person who "willfully fails or refuses to carry out any duty imposed" by the President under the Act may be imprisoned for no more than 3 years or be fined no more than $50,000. 50 U.S.C. App. § 468(f).
[28]—*See* Dep't of Def., DoD 4400.1-M, Department of Defense Priorities and Allocations Manual 10 (2002), *available at* http://www.dtic.mil/whs/directives/corres/pdf/44001m_022102/p44001m.pdf (¶ C1.4.3).
[29]—50 U.S.C. app. § 2071 (2000).
[30]—The other main portion of the Defense Production Act is Title III of the Act under which the President has the authority to assist in the expansion and growth of industrial capacity and supplies of certain products or raw materials. This article will not discuss Title III in depth.
[31]—50 U.S.C. App. § 2071 (emphasis added). This article will focus on the defense priorities and allocations aspects of the Defense Production Act. The Act also has other important features, such as establishing defense trade offsets, maintaining and tracking industrial base sectors, and analyzing the impact of foreign investment on the national security.
[32]—*Id*. § 2062(a)(4)(2000).
[33]—*See generally* E. Airlines, Inc. v. McDonnell Douglas Corp., 532 F.2d 957, 993-94 (5th Cir. 1976).
[34]—Defense Production Act of 1950, ch. 932, 64 Stat. 798 (codified as amended at 50 U.S.C. app. §§2061-2170).

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Implementing the Defense Production Act (cont'd):

Endnotes (cont'd)

[35]—*Id.* §716, 64 Stat. at 822 (codified as amended at 50 U.S.C. app. §2166).
[36]—*See* 50 U.S.C. app. §2166.
[37]—*See Reauthorization of the Defense Production Act of 1950*, *supra* note 8, at 2 (statement of Rep. Peter T. King).
[38]—*The California Energy Crisis and Use of the Defense Production Act: Hearing Before the S. Comm. On banking, Housing, and Urban Affairs,* 107th Cong. 1 (2001) (statement of Sen. Phil Gramm).
[39]—*See* Defense Production Act Amendments of 2001, Pub. L. No. 107-47, §2, 115 Stat. 260, 260
[40]—*See* Defense Production Act Reauthorization of 2003, Pub. L. No. 108-195, 117 Stat. 2892.
[41]—50 U.S.C. App. §4166. There are also statutory provisions that provide the President with additional priorities and allocations powers during wartime or when war is imminent. Under 10 U.S.C. § 2538, the President has the authority "in time of war or when war is imminent" to order "any person or organized manufacturing industry" to produce "necessary products or materials of the type usually produced or capable of being produced by that person or industry." *Id*. §2538(a)(2000). Unlike the Selective Service Act, this statutory provision does not require an authorization for the goods from Congress. The President may also take "immediate possession of any plant that is equipped to manufacture, . . . or is capable of being readily transformed into a plant for manufacturing, arms or ammunition; parts thereof, or necessary supplies for the armed forces" if the person refuses to comply with an order for goods, give precedence to the order, or furnish the goods at a reasonable price. *Id.* §2538(c). The government must provide "fair and just compensation." Failure to comply can subject a person to three years in jail. *Id.* §2538(f). To assist in the process, 10 U.S.C. § 2539 requires the Secretary of Defense to maintain a list of companies that manufacture arms and ammunition, or those plants that can do so if converted, and to have a plan to convert those plants if needed. *See id.* §2539 (2000).
Likewise, under 50 U.S.C. §82, the President has the power during wartime to procure ships and material needed for the U.S. Navy. This power includes the authority to place rated orders for ships or war material, take possession of factories for production of ships or war material if the owner refuses to comply with an order; modify or cancel any contract for building a ship, or to require the owner of a factory to "place at the disposal of the United States" all or some of the output of its factory. *Id.* §82(b) (2000).
[42]—Defense Production Act Reauthorization of 2003, Pub. L. No. 108-195, §5, 117 Stat. at 2893 (codified as amended at 50 U.S.C. app. §2152).
[43]—*See* Moteff *et al*., *supra* note 17, at 2.
[44]—*Id*.
[45]—President's Comm'n on Critical Inrastructure Prot., Critical Foundations: Protecting America's Infrastructures 81 (1997), *available at* http://www.loyola.edu/dept/politics/intel/PCCIP_Report.pdf.
[46]—*Id*.
[47]—Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act (USA PATRIOT Act) of 2001, Pub. L. 107-56, §1016, 115 Stat.272, 400-02 (codified at 42 U.S.C. §5195c (Supp. 2002)).
[48]—42 U.S.C. §5195c(e).
[49]—The CIP Act is included in Title 42 of the United States Code. The CIP Act, however, was enacted as part of the USA PATRIOT Act rather than as part of the reauthorization or amendment to the Stafford Act. *See* USA PATRIOT Act of 2001, Pub. L. 107-56, §1016, 115 Stat. 272, 400-02.
[50]—Homeland Security Act of 2002, 6 U.S.C. §131 (Supp. 2002).
[51]—*See* 6 U.S.C. §101(4).
[52]—Defense Production Act Reauthorization of 2003, Pub. L. No. 108-195, §5, 117 Stat. 2892, 2893 (codified as amended at 50 U.S.C. app. §2152(14)).
[53]—S. Rep. No. 108-156, at 2 (2003).
[54]—*See id*. The Committee cited testimony by R. David Paulison, Director, Emergency Preparedness Division, U.S. Department of Homeland Security, who responded to a question as to whether the Defense Production Act applied to protecting "critical infrastructure": "That is our understanding. It can be either civil or military. The Department of Defense uses it for military, and I think the other agencies here would use it for civil emergencies or disasters within the United States." *Id.*. (internal quotation marks omitted). The Report goes on to state: "The Committee agreed with the view expressed by Mr. Paulison and other Administration witnesses and believe it important to make this authority explicit in the statute." *Id.*.

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Implementing the Defense Production Act (cont'd):

Endnotes (cont'd)

55—On the House Floor, Rep. Peter King of New York made it clear that the Defense Production Act applies to critical infrastructure:

> First, the House of Representatives and the Senate have agreed to include language that makes clear that all the authorities included with the DPA may be used for critical infrastructure protection and restoration purposes. I have been informed that in past administrations there may have been some confusion regarding the applicability of the DPA to critical infrastructure. The language included in the reauthorization legislation ends any debate that may have existed. Secondly, it is the intent of the House that the DPA be interpreted to allow the administration to exercise the authorities provided under Section 101 of the DPA to directly assist a private sector critical infrastructure owner or operator in furtherance of critical infrastructure protection or restoration.

149 Cong. Rec. H9416 (daily ed. Oct. 15, 2003)(statement by Rep. King).

56—50 U.S.C. app. §2152(3)(2000). There are a few slight differences in the definition of "critical infrastructure" given in the Defense Production Act and the one that the DHS has adopted from the USA PATRIOT Act. The Defense Production Act uses the word "cyber-based," while the USA PATRIOT Act refers to "virtual." The Defense Production Act specifically uses the term "national security," while the USA PATRIOT Act uses the term "security." Finally, the Defense Production Act covers systems whose "degradation" would have debilitating impact, while the USA PATRIOT Act coverage appears to require "incapacity" of the system.

57—*Reauthorization of the Defense Production Act of 1950*, *supra* note 8, at 36 (statement of Eric J. Fygi, Deputy General Counsel, Department of Energy).

58—*The California Energy Crisis and Use of the Defense Production Act*, *supra* note 37, at 1.

59—H.R. Rep. No. 108-56, at 12 (2003).

60—HSPD-7, *supra* note 19, at ¶22.

61—U.S. Dep't of Homeland Sec., National Infrastructure Protection Plan (2006), *available at* http://www.dha.gov/interweb/assetlibrary/NIPP_Plan.pdf.

62—*Id*. at 31 (§3.2.1).

63—*Id*. at 137 (app.2A.1).

64—15 C.F.R. pt. 700, sch. 1 (2006).

65—Introduction to Federal Acquisition Circular 2005-11, 71 Fed. Reg. 38,238 (July 5, 2006).

66—FAR Case 2005-038, Emergency Acquisitions, 71 Fed. Reg. 38,247, 38,248 (July 5, 2006).

67—*Id*. at 38,249 (to be codified at 48 C.F.R. §18.108).

68—*See* 50 U.S.C. app. §2071(c)(1) (2000); Exec. Order No. 12,919, 59 Fed. Reg. 29,525 (June 3, 1994).

69—50 U.S.C. app. §2071(c)(2).

70—10 C.F.R. §216.3(a) (2006).

71—50 U.S.C. app. §2071.

72—*Id*. (emphasis added).

73—15 C.F.R. §§700.3(a), 700.11(a) (2006); FAR 11.603(a).

74—15 C.F.R. §700.3(a).

75—*Id*. §700.14 (2006).

76—*Id*. §700.14(b).

77—*Id*. §700.16(c) (2006).

78—*Id*. §700.16(d).

79—*See id*. §700.14(d).

80—*Id*.

81—*Id*. §700.13(c)(3) (2006).

82—50 U.S.C. app. §2071 (2000).

83—15 C.F.R. §700.13.

84—*See* Hercules v. United States, 516 U.S. 417, 431 (1996).

85—See 15 C.F.R. §700.13(a)-(c).

86—*Id*. §700.13(b).

(*continued on next page*)

Implementing the Defense Production Act (cont'd):

Endnotes (cont'd)

[87]—*Id*. §700.13(c)(1).
[88]—*Id*. §700.13(d)(1).
[89]—Defense Priorities and Allocations System (DPAS): Electronic Transmission of Reasons for Rejecting Rated Orders, 70 Fed. Reg. 10,864, 10,864-65 (Mar. 7, 2005)(codified at 15 C.F.R. §700.13(d)).
[90]—Interspace E ng'g & Support, ASBCA No. 14459, 70-1 BCA ¶8,263 (stating that the requirement to "comply to higher priority DX rated orders" could provide the basis for excusable delay under another government contract); *see also* Acme Missiles & Constr. Corp., ASBCA No. 11794, 68-1 BCA ¶6,734 (holding the Government could not assess liquidated damages for delays caused by subcontractor's obligation to delay manufacture of needed components to fill higher-rated orders).
[92]—*Interspace Eng. & Support*, 70-1 BCA ¶8,263 (citing Bromion, Inc., ASBCA No. 12075, 67-2 BCA ¶6,543).
[93]—532 F.2d 957 (5th Cir. 1976); *see also* United States v. Tex. Constr. Co., 224 F.2d 289, 293 (5th Cir. 1955)(finding subcontractor not liable for delays where Government admitted that delays had been caused by priority system).
[94]—CA No. 4-87-312-K, 1988 U.S. Dist. LEXIS 17256 (N.D. Tex., June 9, 1988).
[95]—*Id*. At *11; *see also* Wm. T. Thompson Co. v. United States, 26 Cl . Ct. 17 (1992).
[96]—United States v. Verac Chem. Corp., 46 F.3d 803 (8th Cir. 1995).
[97]—*Id*. At 810.
[98]—*Id*. At 810-11 (internal citations omitted).
[99]—Hercules v. United States, 516 U.S. 417 (1996).
[100]—*Id*. At 429.
[101]—15 C.F.R. §700.15 (2006).
[102]—*See* Margold Elec. Co., ASBCA Nos. 15984, 15985, 72-2 BCA ¶9,646 (holding that contractor's failure to use priority system to expedite delivery from suppliers was cause of contract delay); Boston Pneumatics, inc., ASBCA Nos. 15167, 15635, 71-1 BCA ¶8,918 (holding that failure to deliver on time was not excusable because contractor had failed to include priority rating in subcontracts and had not requested priorities assistance).
[103]—Atlantic Maint. Co., ASBCA No. 40454, 96-2 BCA ¶28,323.
[104]—15 C.F.R. §700.12(a) (2006).
[105]—*Id.* Pt. 700, sch. 1 (2006).
[106]—*Id.*
[107]—*Id.*
[108]—*Id.*
[109]—*See* Hogan Mech. Inc., ASBCA No. 21612, 78-1 BCA ¶13,164 (holding that prime contractor's order requesting that supplier ship "as soon as possible" did not comply with DPAS requirements and therefore was not a rated order).
[110]—15 C.F.R. §700.12(c).
[111]—*Id.* §700.12(d).
[112]—General Services Administration Acquisition Regulation; Defense Priorities and Allocation System, 69 Fed. Reg. 55,934 (Sept. 16, 2004)(to be codified at 48 C.F.R. pts. 511, 552).
[113]—GSAR 511.603(a).
[114]—GSAR 511.603(d).
[115]—15 C.F.R. §700.50(a) (2006).
[116]—FAR 11.603(g).
[117]—44 C.F.R. §329.2(a) (2006).
[118]—*See* McQuiston Assocs., ASBCA No. 24676, 83-1 BCA ¶16,187 (finding delay not excused where contractor failed to request priorities assistance in timely manner).
[119]—*See* FAR 11.602(e).
[120]—50 U.S.C. app. §2156 (2000).

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<u>Mixed Messages (cont'd from page 22)</u>:

It is not the purpose of this paper to retrace the ground that Messrs. Doke and Johnson have expertly traveled. Rather, I aim to expand upon their discussion of the current state of the case law and its consequences and will discuss how the apparent conflict might best be resolved.

The problem arises from the application of two inconsistent standards by the judicial forums that-hear contract disputes between the Government and its contractors. The *first principle* arises from the duty that is imposed upon each party to a contract to deal fairly and in good faith with the other party to the contract. The *Restatement (Second) of Contracts* provides substantial guidance as to what this duty entails, which is addressed in connection with the discussion of the case law below.

The *second principle* was created by the Court of Federal Caims (COFC)(at the time, the Claims Court) and adopted and revised at various times by the Court of Appeals for the Federal Circuit (Federal Circuit). The *second principle* was carried over from a previously existing principle that applied to the conduct of government personnel acting in a *sovereign* capacity, rather than a *contractual* capacity. The second principle posits that government employees acting in their official capacities are presumed to act in good faith.[5]

Therefore, the question arises whether it is appropriate to apply the presumption of good faith (or regularity) to the conduct of government employees acting in a *contractual* capacity and, if so, what standards must contractors meet to overcome the presumption. Mr. Doke voiced his opinion on the presumption as follows:

> c. Presumption of Good Faith. There is a strong presumption that government officials act in good faith. *Torncello v. United States*, 681 F.2d 756, 770 (Ct. Cl. 1982). The presumption is so strong that, until recently, it took "well-nigh irrefragable proof" to overcome the presumption. *Kalvar Corp. v. United States*, 543 F.2d 1298, 1301-02 (Ct. Cl. 1976), *cert. denied*, 434 U.S. 830 (1977). Recently, the Federal Circuit said it takes "clear and convincing" evidence (not just a preponderance of evidence) to overcome the presumption. The presumption may be appropriate for actions of officials in the Government's *sovereign* capacity, but it should not be used to give the Government an advantage in contractual disputes if the Government is to be treated as other private parties. Why should it be presumed that government employees act in good faith but contractor employees do not?

II. The Current State of the Law Governing the Conduct of Government Procurement Personnel Is Muddled

A. Two Recent Decisions At The Court of Federal Claims, *LP Consulting Group* and *Systems Fuels Inc.*, Apply Both Legal Standards To The Conduct of Government Contracting Personnel

To understand the confusion that persists in this area of the law, it is helpful to examine two of the most recent COFC decisions.[7] In *L.P. Consulting*, issued on July 7, 2005, the court articulated the *first principle* — the Government's duty of good faith and fair dealing — without commentary or analysis, and then promptly negated it by applying the *second principle*. The court applied the *first principle* in shorthand: "To be sure, the government has an implied obligation to carry out its duties under a contract in good faith."[8]

(*continued on the next page*)

Mixed Messages (cont'd):

In mentioning the *first principle*, the court cited two decisions issued by the Federal Circuit, one almost two decades ago (*Malone*) and the second four decades ago (*Commerce International Co*.).[9] After mere mention of the principle that requires the Government to deal fairly and in good faith with its contractors, the court effectively negated this principle by applying the presumption of good faith to the Government's contractual action. The court further provided that the presumption could be successfully rebutted only by a presentation of clear and convincing evidence of "specific intent to injure" the contractor — i.e., animus:

> In order to demonstrate a breach of such duty, plaintiff must demonstrate that the government acted in bad faith. It is well-settled, however that government officials are presumed to act conscientiously and in good faith in the discharge of their duties. In order to overcome this presumption, plaintiff "must *allege and prove*, by clear and strong evidence, specific acts of bad faith on the part of the government." The level of proof to overcome this presumption is high, often described as requiring "well nigh irrefragable proof." While this standard is not intended to "insulate government action from *any* review by courts," in this circuit, it has "been equated with evidence of some *specific intent to injure the plaintiff.*"

In *Systems Fuels, Inc. v. United States*, issued July 29, 2005, the COFc dealt in even more cursory fashion with the *first principle*, merely mentioning it in a heading. The court mentions the *first principle* in a brief introduction to its extensive legal discussion and application of the *second principle*, which again had the effect of negating the *first principle*. The court stated:

> 2. On Count II — Breach of the Implied Covenant of Good Faith and Fair Dealing
>
> The Complaint also alleged that the Government breached the implied duty of good faith and fair dealing under the Standard Contract by:
>
> * * *
>
> SFI, however, has failed to proffer sufficient evidence to overcome the presumption that the relevant government officials have acted in good faith. *See Am-Pro Protective Agency v. United States*, 281 F.3d 1234, 1239 (Fed.Cir.2002) ("[T]he clear and convincing standard most closely approximates the language traditionally used to describe the burden for negating the good faith presumption [afforded to Government officials.]"); *see also Sanders v. United States Postal Service*, 801 F.2d 1328, 1331 (Fed.Cir.1986)) ("There is a strong presumption in the law that administrative actions are correct and taken in good faith."); Where there is an allegation of bad faith by the Government, the court usually requires evidence of "some specific intent to injure the plaintiff." *Id.* at 1240 (quoting *Kalvar Corp., Inc. v. United States*, 211 Ct.Cl. 192, 543 F.2d 1298, 1302 (1976)); *see also Caldwell & Santmyer, Inc. v. Glickman*, 55 F.3d 1578, 1581 (Fed.Cir.1995) ("A contractor can overcome [the presumption that the Government acts in good faith] only if it shows through 'well nigh irrefragable proof' that the government had a specific intent to injure it.").
>
> * * *
>
> *See Am-Pro Protective Agency*, 281 F.3d at 1240 ("[T]he requirement of 'well-nigh irrefragable' proof … sets a high hurdle for a challenger seeking to prove that a government official acted in bad faith."). Therefore, SFI has failed to overcome the presumption that the Government acted in good faith.
>
> (*continued on next page*)

<u>Mixed Messages (cont'd)</u>:

B. Voices of Reason in the Fray: *Centex* and *Tecom*

What is curious about the *L.P. Consulting* and *Systems Fuels* decisions is that neither discusses the two most recent decisions that were relevant to the legal principles involved. The court fails to discuss *Centex*, issued by the Federal Circuit in January 2005, and *Tecom*, issued by the COFC on June 27, 2005.[12] *Centex* was not a procurement case and therefore did not fall under or discuss the line of cases that applied the second principle — the presumption that government employees act in good faith even in the contractual arena. Rather, *Centex* dealt with the fundamental issues that were addressed in the landmark Supreme Court case *United States v. Winstar Corp.* regarding the definition and interplay between the Government's role a s a sovereign and its role as a contracting party.[13]

In *Centex*, the plaintiffs contended Congress had enacted legislation that had both the intention and effect of depriving Centex of the benefit of the (nonprocurement) contracts they had executed with the Government.

The COFC rejected the Government's arguments that its legislative actions as a *sovereign* overrode its *contractual* obligations. The Federal Circuit affirmed the COFC and confirmed what the Supreme Court made clear in *Winstar* (and for more than 100 years prior to the issuance of *Winstar*)[14] — the duty of good faith and fair dealing that is implied into every contract "applies to the government just as it does to private parties."[15]

The Supreme Court in *Winstar* articulated the critical need to subject the Government to the same duties and obligations to which private parties are subjected when they contract, including the duty of good faith and fair dealing that is implied into every contract. In addressing the difficult issue of the interplay between government actions in its sovereign capacity and government actions in its contractual capacity, the Supreme Court noted:

> An even more serious objection is that allowing the Government to avoid contractual liability merely by passing any "regulatory statute" would flout the general principle that, *"[w]hen the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals."* *Lynch v. United States*, 292 U.S., at 579, 54 S.Ct., at 843. Careful attention to the cases shows that the sovereign acts doctrine was meant to serve this principle, not undermine it.[16]

The principle the emerges unquestionably from *Winstar* and *Centex* is that the Government must honor its contractual obligations; *it cannot take action that would effectively deprive its contractors of the anticipated fruits of their contracts*.[17]

In *Tecom*, Judge Wolski follows, with remarkable precision, the winding path that has led to the current state of confusion regarding the standard that is applied to the conduct of government employees acting in a nondiscretionary *contractual* context and the standard contractors must meet to demonstrate that the Government has breached its obligation of good faith and fair dealing under a government contract.[18] Any attempt to articulate the judge's detailed analysis here would be folly. Suffice it to say that the judge traces how the deference accorded to the *sovereign* acting in a discretionary capacity inappropriately leaked its way into the nondiscretionary *contractual* context, stating:

(*continued on next page*)

<u>Mixed Messages (cont'd)</u>:

> The Court concludes that claims of a breach of the implied covenant of good faith and fair dealing -- including claims that the duties to cooperate and not hinder performance of a contract have been breached -- are to be treated like any other claim for breach of contract. *The presumption of good faith conduct of government officials has no relevance. Were it otherwise, and were the presumption considered particular to government officials, it would no longer be the case that "[t]he duty applies to the government just as it does to private parties*[.]"[19]
>
> The court further noted:
>
> This would be a rejection of the long-held notion that "the principles which govern requires as to the conduct of individuals, in respect to their contracts, are equally applicable where the United States are a party."[20]

The *Tecom* decision quotes from section 205 of the *Restatement (Second) of Contracts*, which addresses in substantial detail the duty of good faith and fair dealing that is implied into every contract.[21] In so doing, the court recognizes that a breach of the duty can occur with even a failure to act, or an action that falls far short of intent to injure the other party (*animus*):

> The Restatement (Second) of Contracts has found that "[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement." Restatement (Second) of Contracts § 205 (1981). Although this duty is stated in terms of "good faith," proof of bad intent does not appear to be required in order for a breach to be found. As the Restatement explains:
>
> > Subterfuges and evasions violate the obligation of good faith in performance even though the actor *believes his conduct to be justified*. But the obligation goes further: bad faith may be overt or may consist of inaction, and fair dealing may *require more than honesty*. A complete catalogue of types of bad faith is impossible, but the following types are among those which have been recognized in judicial decisions: … lack of diligence and slacking off … and interference with or failure to cooperate in the other party's performance.
>
> *Id*. comment d (emphasis added).[22]

C. The Confusion And Mixed Message Persist: Two Decisions Issued By The Court of Federal Claims Almost Contemporaneously with the *LP Consulting* And *Systems Fuels* Decisions Applied the *Centex* and *Tecom* Reasoning Rather Than the *LP Consulting* and *Systems Fuels* Reasoning: *H&S Manufacturing* and *Helix Electric*

In beginning his analysis of the conflicting legal principles that the COFC and Federal Circuit have often applied, Judge Wolski noted: "This area of jurisprudence has persisted in its elusiveness."[23] So it continues today, notwithstanding the decisions in *Centex* and *Tecom*. To be sure, progress is evident. On July 18, 2005, five weeks after the COFC issued the *L.P. Consulting* decision and less than two weeks before it issued the *Systems Fuels* decision, Judge Christine Miller of the COFC announced, "The Government's long touted desideratum that 'irrefragable proof' is needed to demonstrate the absence of good faith in the administration of government contracts has been given its last rites."[24]

(*continued on next page*)

<u>Mixed Messages (cont'd)</u>:

Judge Miller attempted to hammer her own nail into the *Kavlar*[25] coffin in which the presumption of good faith and clear and convincing proof of animus purportedly now lie:

> Determinations of whether the duty of good faith and the duty not to hinder performance have been breached are based on similar considerations.[FN19] Generally, a failure to cooperate with the other party in the performance of a contract serves as a breach of that contract because a failure to cooperate violates the duty of good faith. *See Malone v. United States*, 849 F.2d 1441, 1445 (Fed.Cir.1988). Notably, however, a showing of "bad faith" or "bad intent" is not required to demonstrate a breach of this implied duty. *Abcon Assocs. V. United States*, 49 Fed.Cl. 678, 688 (2001). Instead, the Restatement (Second) of Contracts is instructive: "Subterfuges and evasions violate the obligation of good faith in performance even though the actor believes his conduct to be justified." Restatement (Second) of Contracts § 205 (1981). Comparatively, the duty not to hinder is breached when the Government commits "actions that unreasonably cause delay or hindrance to contract performance." *C. Sanchez & Son, Inc. v. United States*, 6 F.3d 1539, 1542 (Fed.Cir.1993). As such, a government official cannot "willfully or negligently interfere with the contractor in the performance of his contract[.]"[26]

Similarly, Judge Williams, in *Helix Electric Inc. v. United States*, refused to inject the presumption of good faith into her analysis of the Government's contractual conduct, but instead judged the Government's conduct using standard breach of contract principles.[27]

So, with the decisions in *Centex*, *Tecom*, *H&S Mfg*., and *Helix*, perhaps Judge Miller is correct in fueling the *Kevlar* pyre. But given the decisions in *L.P. Consulting* and *Systems Fuels*, the wake seems premature. Although Judge Wolski in *Tecom* read the Federal Circuit's decision in *Am-Pro Protective Agency, Inc. v. United States* in the most favorable light possible to facilitate his analysis,[28] the Am-Pro decision still leaves cause for concern.

So, we ask the question again: "Are we 'there' yet?" Answer: No, not yet. But so what? What is the significance?

When the COFC, Federal Circuit, or Boards of Contract Appeals cloak the formal, nondiscretionary contractual actions of government employees with a *sovereign* presumption of good faith and regularity, they render meaningless the *contractual* duty of good faith and fair dealing that it otherwise imposed upon these employees. This presumption violates the very principle that the Supreme Court and the *Restatement (Second) of Contracts* deems are inherent in every contract. To hold otherwise presents the very oxymoron Judge Wolski tries to avoid, i.e., government procurement personnel have a duty to deal fairly and in good faith with contractors; but government procurement personnel are presumed to act in good faith and to prove otherwise requires introduction of "well-nigh irrefragable" evidence.

Consider the analogy of parents raising teenage children. During a time when I taught and coached at high school, I saw parents tell their children to be "good"; be nice"; act with "honor," "integrity," and "character." Some of the children, however, proceeded to act as spoiled, petulant brats, and sometimes worse. The parents often smiled and said variously, "kids will be kids" or "yes, that was not a good act; but, you know, they're good kids." On such occasions, I might respond, " Yes, I hope and believe that is true. But they are not *acting* like good kids. They have to *act* like good kids before we can say they *are* good kids." For, as Aristotle, one of the pillars of secular ethics, believed that we are what we continually do — excellence then is a habit. We can be ethical only by *acting* ethically.
(*continued on next page*)

<u>Mixed Messages (cont'd)</u>:

The parents were applying an essentially irrefutable "presumption of regularity" to the children's actions. They sent the first message: "Act like a 'good' kid — honorably and with integrity; treat peope with respect and civility." The parents immediately negated this message by sending an overriding message: "*Anything* you do, honey, is all right We will *always* defend your conduct of any nature, which is by definition 'good,' because, after all, you are a 'good' kid."

All of the kids' acts by definition became "good" (or at least not "bad" or a cause for disciplinary or even educational action). Not surprisingly, the kids quickly and thoroughly adjusted their behavior accordingly — *they did whatever they wanted to*, knowing they had the absolute benefit of an almost irrefutable presumption of regularity ("yes, that was an unfortunate act, but he's a '*good*' kid").

The *second parental message* — "no one can ever question your actions unless you act heinously (and get caught)" equates in the business world to the presumption of good faith and regularity judicially accorded to government employees, which can be refuted only by "well nigh irrefragable" evidence of animus. This message completely negates the first parental message — "you and your actions will be judged according to a specific standard of conduct, a standard of honor, integrity, and civility" that equates in the business world to the duty of good faith and fair dealing.

Like the students in our school example, many government employees acting in their nondiscretionary contractual capacities have learned well the mixed message that the COFC, the Federal Circuit, and the Boards of Contract Appeals often have sent them. Their conduct is almost certainly related to the message that is sent. We cannot expect their conduct to change unless the message is changed. As a first step, the courts and boards need to apply the law that the Supreme Court has articulated, and the *Restatement (Second) of Contracts* sets out, with respect to the Government's obligation to observe the duty of good faith and fair dealing that it assumes when it contracts. If the confusion nin the judiciary with regard to this issue persists, a legislative or other fix is warranted.

III. Current Codes of Conduct and Other Guidance Governing the Conduct of Government Procurement Personnel Are Essentially Silent With Regard to This Important Topic

Several questions are warranted at this point in the analysis:

1) Is it enough merely to right the judicial ship with regard to the confusion?

Answer: No.

2) Do current codes or guiding principles for procurement professionals adequately address this problem?

Answer: No.

3) Does the issue relate only to Government employees?

Answer: No.

It is an axiom of human psychology that humans will act in accordance with the mores of their society, as I attempted to demonstrate in my brief discussion of the analogy regarding high school students. The history of man bears this out, as do current events. Education is one solution to the problem that is the topic of this paper. By virtue of the judicially created presumption of good faith and regularity,

(*continued on next page*)

<u>Mixed Messages (cont'd)</u>:

By virtue of the judicially–created presumption of good faith and regularity, Government procurement employees have been told for some time that their conduct is all but unchallengeable in many instances. The biggest problem is not that Government employees act arbitrarily or without purpose. The bigger problem is that they act *only* in pursuit of what they perceive are the Government's "best interests." These employees are not to be chastised or vilified for this – for nearly every piece of training they are given orients them in this fashion. They are reminded at every turn that their paramount job is to guard and advance the Government's interests, the public trust, at all costs. For some employees, this translates into – "Always obtain the best result you can possibly obtain for the Government, without regard to what has passed to date, contractually or otherwise." Since their actions effectively cannot be challenged once they are cloaked in the judicial presumption of good faith and regularity, these employees become emboldened, blind, in their pursuit of the Government's "best interests." There are few if any negative (and often positive) consequences, and often good consequences, if they attempt to reform the terms of a contract the Government now prefers reformed.

Two things are required to remedy this: 1) education and training, and 2) consequences for breach of the duty of good faith and fair dealing. The Supreme Court stated this most effectively in *Winstar*. The Court noted that while some in the Government might think it is in the Government's best interests to breach contractual duties, and the duty of good faith and fair dealing when it is expedient to do so, in the long run, such action works to the detriment of not only the contractors involved, but also the Government and the public at large:

> The Government's position would not only thus represent a conceptual expansion of the unmistakability doctrine beyond its historical and practical warrant, *but would place the doctrine at odds with the Government's own long-run interest as a reliable contracting partner in the myriad workaday transaction of its agencies*.
> * * *
> Injecting the opportunity for unmistakability litigation into every common contract action would, however, produce the untoward result of compromising the Government's practical capacity to make contracts, which we have held to be "of the essence of sovereignty" itself. From a practical standpoint, it would make an inroad on this power, by expanding the Government's opportunities for contractual abrogation, with the certain result of undermining the Government's credibility at the bargaining table and increasing the cost of its engagements. As Justice Brandeis recognized, '[p]unctilious fulfillment of contractual obligations is essential to the maintenance of the credit of public as well as private debtors."[29]

It is important to note that the confusion regarding precisely what is and is not in a contracting party's "best interests" is not merely a Government problem. The problem is endemic to the current business climate, and to society as a whole. Arguably many of today's business scandals, and certainly many of today's business failures, are the result of a misconception regarding precisely what it is that constitutes a company's best interests at any point in time. Recent events have shown that, for many in the business world, short-term gains outweigh long-term objectives and the overall health of their organizations. For those who seek only short-term gains, leverage in business dealings should always be maximized, even when dealing with one's regular business partners.30

In his paper, Stanfield Johnson recounts a series of litigation stories that chill counsel for contractors to the bone. He recounts cases in which government personnel and counsel have bullied contractors, stretched the truth, ignored the facts as well as their contracts, and even lied on the witness stand. These

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Mixed Messages (cont'd):

are reprehensible and grotesque stories. But I have confidence that, for many of the stories that involve adoption of an overly aggressive position by Government personnel or counsel, we can find similar stories that involve contractor personnel or counsel. Some people stretch the truth in litigation, and others abuse the business leverage they enjoy over others.

The major difference in the Government contracting arena lies in the area of consequences. The False Claims Act[31] is truly an awesome deterrent. So are suspension and debarment, claim forfeiture, loss of all contract payments, loss of one's job, and so on. Contractor employees and their counsel live in constant fear of these potential consequences. Government employees, at least at lower and some mid-management levels, are generally not subject to these potential consequences.

It is simply a fact that potential consequences drive human action. When a contractor's employee takes a position that subjects the contractor to substantial exposure, and that position is found by a judicial body to be clearly unjustified under the terms of the applicable contract, that employee's career often takes a decidedly downward turn. The same does not always happen to government employees. One of the reasons for this is that both the government employees and their superiors sometimes operate under the illusion that they act in the Government's "best interests" when they push the envelope. Thus, these employees attempt to obtain the best result they can achieve for the Government without regard to what has transpired prior to that point in time. As Mr. Johnson notes, in such instances, the overly aggressive position is not seen as cause for demotion but rather for congratulations on a "good try" foiled.[32] I believe that this is not the product of malicious intent. Rather, such action is the product (and here I do mean in the mathematical sense) of a lack of understanding as to what is truly in the Government's best interests multiplied by the application of a presumption of good faith further multiplied by lack of consequences.[32]

In addition to the elimination of the judicial presumption of good faith and regularity, we need a code or set of principles to guide the contracting community in this area. Personally, I think it best not to invoke the word "ethics" in this regard, which has both charged and limited connotations. Similarly, the word "code" may carry an unproductive tone. We might then consider promulgation of a set of principles that explain the concept of the duty of good faith and fair dealing that is implied into every government contract. This set of principles should apply to all members of the government contracting community, government employees and contractor employees alike.

With minor exception, current codes and principles of conduct aimed at Government employees address only the employees' obligations to act in the Government's "best interests" at all times. With little exception, this translates into rules and principles that focus exclusively on controlling perceived abuses by contractors including acts constituting fraud, waste and abuse, or simply actions by contractors or situations that yield windfalls for contractors.[34] Consider, for example, the fourteen principles contained in the Standards of Official Conduct that President Bush issued in 2001 to the heads of all executive departments and agencies.[35] None of the principles addresses the duty of Government employees to deal with their contractors fairly and in good faith.

The Darleen Druyan scandal and the responses it provoked within the Government have stimulated the beginnings of a recognition of the need to train government employees regarding the duty of good

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Mixed Messages (cont'd):

faith and fair dealing. However, at the moment, these are small sparks yet to produce fire. For example, in the wake of the Druyun scandal, the Defense Science Board (DSB) conducted a comprehensive study with its stated purpose being to "[a]ssess oversight to ensure the integrity of acquisition decisions in DoD."[36] In listing the factors that led to the scandal, the DSB specifically noted "abusive behavior to subordinates and contractors that was not apparent, or viewed as 'tough but fair' by supervisors."[37]

In announcing the DSB Task Force findings to acquisition community leaders, Acting Under Secretary of Defense Wynne stated:

> While expediency and results are important, the manner in which we conduct ourselves is even more important. If we make unethical decisions to expedite our acquisitions, we are doing a disservice to the American people. I ask that you and your senior leadership discuss these issues at every opportunity, in meetings and forums, within your community and with your industry partners. Please make acquisition integrity and ethics the center of your everyday decision-making culture.[38]

Similarly, in his September 7, 2005 memorandum addressing the same topic, Secretary of Defense Rumsfield stated, "[t]he task force emphasized that our focus must not only be on 'doing things right' but also on 'doing the right things'."[39] Unfortunately, meaningful guidance and training to implement these brief references appears lacking at this time.[40]

A government contracting code or set of principles of good faith and fair dealing should be developed. As Mr. Johnson suggests,[41] there is no better place to begin in this process than Section 205 of the *Restatement 2nd of Contracts* itself, which provides:

> a. *Meanings of "good faith.*" Good faith…means "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." The phrase "good faith" is used in a varietyof contexts, and its meaning varies somewhat with the context. Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes a variety of types of conduct characterized as involving "bad faith" because they violate community standards of decency, fairness or reasonableness….
>
> * * *
>
> d. *Good faith performance*. Subterfuges and evasions violate the obligation of good faith in performance even though the actor believes his conduct to be justified. But the obligation goes further: bad faith may be overt or may consist of inaction, and fair dealing may require more than honesty. A complete catalogue of types of bad faith is impossible, but the following types are among those which have been recognized in judicial decisions: evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of a power to specify terms, and interference with or failure to cooperate in the other party's performance.
>
> * * *
>
> e. *Good faith in enforcement.* The obligation of good faith and fair dealing extends to the assertion, settlement and litigation of contract claims and defenses….The obligation is violated by dishonest conduct such as conjuring up a pretended dispute, asserting an interpretation contrary to one's own understanding, or falsification of facts. It also extends to dealing which is candid but

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Mixed Messages (cont'd):

> unfair, such as taking advantage of the necessitous circumstances of the other party to extort a modification of a contract for the sale of goods without legitimate commercial reason….Other types of violation have been recognized in judicial decisions; harassing demands for assurances of performance, rejection of performance for unstated reasons, willful failure to mitigate damages, and abuse of a power to determine compliance or to terminate the contract.[42]

IV. Conclusion: What Should Be Done?

1. The courts and boards need to apply the law that the Supreme Court has articulated, and that the *Restatement (Second) of Contracts* sets out, with respect to the Government's obligation to observe the duty of good faith and fair dealing that it assumes when it contracts. The presumption of good faith and regularity as it relates to the contractual context should be eliminated. If the confusion in the judiciary with regard to this issue persists, a legislative or other remedy is warranted.

2. Implement and teach a code—or set of principles—of good faith and fair dealing that applies to all in the government contracting community, with its backbone being Section 205 of the *Restatement (Second) of Contracts.*

3. there should be some consequences for conduct in violations of the code (principles) of good faith and fair dealing, whether done by contractor or government personnel. Accordingly, a system of appropriate sanctions should be carefully designed, evaluated, and, once established, applied as necessary and appropriate. The nature of such a system remains for others to devise. For example, contractors could incorporate sanctions into their codes of conduct and the government could implement sanctions through each agency's personnel regulations or have the office of Government Ethics establish and implement the sanctions.

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Endnotes

[1]—Part of the Acquisition Advisory Panel, formed under the Services Acquisition Reform Act, Pub. L. No. 108-136, §1423, 117 Stat. 1392, 1669 (2003).

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Mixed Messages (cont'd):

Endnotes (cont'd)

[2]—*See* Proposal for Public Comment on Commercial Practices Legislation from Marshall Doke to Commercial Practices Working Group, Acquisition Advisory Panel 4 (May 5, 2005).
[3]—*Id.* at 1.
[4]—*See* W. Stanfield Johnson, *NEEDED: A Government Ethics Code And Culture Requiring Its Officials To Turn "Square Corners" When Dealing With Contractors*, 19 No. 10 Nash & Cibinic Rep. ¶47, at 150.
[5]–The judicial derivation and evolution of this principle is discussed in riveting detail in Judge Wolski's decision in the case of *Tecom v.United States*, 66 Fed. Cl. 736 (2005). *See infra* Part II.C.
[6]—Doke, *supra* note 2 (quoting Kavlar v. United States, 543 F.2d 1298, 1301-02 (Ct. Cl. 1976))(internal citations omitted).
[7]–*See* L.P. Consulting Group v. United States, 66 Fed. Cl. 238 (2005); System Fuels, Inc. v. United States, 66 Fed. Cl. 722 (2005).
[8]—*L.P Consulting*, 66 Fed. Cl. at 243 (citing Malone v. United States, 849 F.2d 1441, 1445 (Fed. Cir. 1988); Commmerce Int'l Co. v. United States, 167 Ct. Cl. 529 (1964).
[9]—Curiously, the Court did not cite the Federal Circuit's recent decision in *Centex Corp. v. United States*, 395 F.2d 1283 (2005). *See infra* Part II.D.
[10]—*L.P Consulting*, 66 Fed. Cl. at 243 (emphasis in original)(internal citations omitted).
[11]—*Systems Fuels*, 66 Fed. Cl. at 735 (internal citations omitted).
[12]—*LP Consulting* cites to the *Centex* decision but does not discuss it. Centex, 395 F.3d 1283; Tecom, Inc. v. United States, 66 Fed. Fl. 736 (2005).
[13]—518 U.S. 839 (1996).
[14]—*See e.g.*, Cooke v. United States, 91 U.S. 237, 242 (1875); United States v. Boswick, 94 U.S. 65, 66 (1877); Lynch v. United States, 292 U.S. 571, 579 (1934).
[15]—Centex Corp. v. United States, 395 F3d 1283, 1304 (Fed. Cir. 2005)(internal citations omitted)("the covenant of good faith and fair dealing is an implied duty that each party to a contract owes to its contracting partner. The covenant imposes obligations on both contracting parties that include the duty not to interfere with the other party's performance and not to act so as to destroy the reasonable expectations of the other party regarding the fruits of the contract. The duty applies to the government just as it does to private parties.").
[16]—*Winstar*, 518 U.S. 839 at 895 (citing *Lynch*, 292 U.S. at 579)(emphasis added) (internal citations omitted).
[17]—*See also* Mobil Oil Exploration & Producing Southeast, Inc. v. United States, 530 U.S. 604, 605 (2000); Franconia Associates v. United States, 536 U.S. 129, 130, 141 (2002).
[18]—Tecom, Inc. v. United States, 66 Fed. Cl. 736 (2005).
[19]—*Id.* at 771 (quoting *Centex*, 395 F.3d at 1304).
[20]—*Id.* (quoting United States v. Smith, 94 U.S. 214, 217 (1877))(emphasis added).
[21]—*Id.* ("The Restatement (Second) of Contracts has found that '[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement." (quoting Restatement (Second) of Contracts §205 (1981))).
[22]—*Id.* at 770 (emphasis in original).
[23]—*Id.* at 768.
[24]—H&S Mfg., Inc. v. United States, 66 Fed. Cl. 301, 312 n. 19 (2005)(citing Tecom, Inc. v. United States, 66 Fed. Cl. 736, 766 n. 36 (2005)).
[25]—*See* Johnson, *supra* note 4.
[26]—*H&S Mfg.*, 66 Fed. Cl. at 311-311 (internal citations omitted).
[27]—68 Fed. Cl. 571, 586-87 (2005)(citing Centex Corp. v. United States, 395 F.3d 1283, 1304 (Fed. Cir. 2005); *Tecom*, 66 Fed. Cl. At 762-63; *H&S Mfg.*, 66 Fed. Cl. at 310).
[28]—281 F.3d 1234, 1239 (Fed. Cir. 2002). See *Tecom*, 66 Fed. Cl. At 768-69.
[29]—United States v. Winstar *Corp.*, 518 U.S. 839, 883-885(1996)(internal citations omitted).
[30]—It was Chairman Mao, I believe, who said "International ethics comes out of the end of a gun." In marked contrast, Socrates said, "No one does wrong wittingly." He believed so powerfully in the rule of reason that he argued that every person will do what is right and just if he or she truly understands what is right and just. As we know, Socrates' pronouncements were

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Mixed Messages (cont'd):

Endnotes (cont'd)

the trunk from which most Western philosophy has sprung, including many branches that have denounced his pronouncements. In any case, the point is—one cannot *know* until one has been exposed to that which is *to be known*: in this case, the duty of good faith and fair dealing. Training and education of the procurement community is unquestionably needed.

[31]—31 U.S.C. §3729 (2000); 18 U.S.C. §287 (2000).

[32]—*See* Johnson, *supra* note 4, at 2.

[33]—In formula form: (A) lack of understanding x (B) nearly irrefutable presumption of regularity of actions x (C) lack of consequences = (DD) license to ignore contract provisions when expedient to do so; arguably, the Darleen Druyun formula.

[34]—Some in the bar cite the provisions of the Procurement Integrity Act and implementing regulations as noteworthy exceptions. However, even these provisions are largely aimed at benefiting the Government – although fairness to contractors is certainly one underlying objective. Further, the effect of these provisions is limited essentially to pre-award situations and does not apply to the arena in which 90 percent of Government-contractor interface occurs—contract performance and administration.

[35]—*See* Memorandum on Standards of Official Conduct From President George W. Bush to The Heads Of Executive Departments and Agencies (Jan. 20, 2001), *available at* http://www.whitehouse.gov/news/releases/2001014-2.html.

[36]—*See* Def. Sci. Bd. Task Force, U.S. Dep't of Def., *Management Oversight in Acquisition Organizations* 5 (2005), available at http://www.acq.osd.mil/dsb/reports/2005-03-MOAO_Report_Final.pdf.

[37]—*Id*. at 1.

[38]—*See* Memorandum on Acquisition Integrity and Ethics from Michael W. Wynne, Acting Undersecretary of Defense for Acquisition, Tech. and Logistics to the Leaders of the Acquisition Workforce (Mar. 22, 2005)(reprinted in *Policy & Legislation*, Def. AT&L, July-Aug 2005, at 85, *available at* http://www.dau.mil/pubs/dam/07_08_2005/july-august_05.pdf.

[39]—Memorandum on Ethics and Integrity from Donald Rumsfeld, Sec'y of Def., to the Sec'ys of the Military Dep'ts (Sept. 7, 2005))(reprinted in *Policy & Legislation*, Def. AT&L, Jan-Feb 2006, at 67, *available at* http://www.dau.mil/pubs/dam/01_02_2006/jan-feb06.pdf.

[40]—*See* FAR 1.102-2(c) (2003) (requiring Government acquisition personnel to "[c]onduct business with integrity, fairness and openness"). As with adverse consequences for violating these performance standards, however, practical guidance on their implementation currently appears insufficient.

[41]—*See* Johnson, *supra* note 4, at 5.

[42]—Restatement (Second) of Contracts §205 (1981).

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More Than You Will Ever Want to Know About Material Overhead

by
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As an experienced practitioner, I well understand that material overhead is not exactly the hot topic in government cost accounting these days – or likely ever will be. Nonetheless, at some uncertain future point in time the occasion may arise where someone might want to know something about this subject (perhaps . . . maybe . . . it could happen . . .). That person will have strayed far from the government contract information boulevards, past the many streets of research topics, and into the small cul-de-sac of material overhead. This article is meant for that lonesome explorer.

Overhead pools are collections of indirect costs, and there are many different types of overhead pools. There are such things as: home office overhead and field office overhead; manufacturing overhead and engineering overhead; and (of course) there is material overhead. All overheads are expressed as a percentage or ratio, and this number is derived from a numerator (the number on top) and a denominator (the number on the bottom). The numerator of a material overhead rate is the collection of all allowable costs related to the handling of the materials involved, which is consistent with the goal of full cost absorption. However, the denominator, which is also referred to as the base, presents the only real problem in this area.

The difficulty is that the term "allocation base" is itself not defined, either in the Federal Acquisition Regulation (FAR) or the Cost Accounting Standards (CAS). Not only is the term not defined, but there is only the briefest discussion of this term in the FAR[1]:

> . . . The contractor shall determine each grouping so as to permit use of an allocation base that is common to all cost objectives to which the grouping is to be allocated. The base selected shall allocate the grouping on the basis of the benefits accruing to intermediate and final cost objectives.

For CAS-covered contracts, the allocation base selected for an indirect cost grouping should normally be either resource consumption or output of activities[2]. However, material overhead does not consume resources nor is there a causal-beneficial relationship in its output of activities. Instead of defining an allocation base for material overhead, CAS 418.50(e)(3) merely sets forth the following guidance:

> If neither resources consumed nor output of the activities can be measured practically, a surrogate that varies in proportion to the services received shall be used to measure the resources consumed. Generally, such surrogates measure the activity of the cost objectives receiving the service.

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Material Overhead:

Note the circular reasoning: "If neither *resources consumed* nor output of the activities can be measured practically, a surrogate that varies in proportion to the services received shall be used to measure *the resources consumed*." For those establishing a material overhead pool, this guidance is obviously unhelpful.

The lack of a definition of allocation base is particularly significant for material overhead determinations. This is because it is not always clear what the base should consist of, and there is no uniformity of practice in this area. Direct material costs are in the base, but the cost of parts for inventory may or may not be. Similar uncertainty arises with respect to the costs of subcontractors that perform only services such as assembly, inspection, coating or finishing operations. For CAS-covered contracts, CAS 418[3] applies and somewhat limits a contractor's discretion in this area. Specifically, CAS 418.50(a)(2) requires as follows:

> All significant elements of the selected base shall be included.

Some manufacturing operations are very sophisticated and involve various multi-stepped processes. Of course, these are determined operationally. While it is axiomatic that the generation of costs parallels the work, mathematically speaking the creation of additional material overhead pools may have an insignificant impact on the total costs. In the absence of regulatory compulsion (i.e., where CAS does not apply), contractors should exercise common sense and only develop a material rate where the costs involved justify the effort. FAR Part 31 states as much where it permissively provides[4]:

> When substantially the same results can be achieved through less precise methods, the number and composition of cost groupings should be governed by practical considerations and should Not unduly complicate the allocation.

From all of the above, it can be seen that there is little guidance in this ill-defined area, even for CAS-covered contracts. Not surprisingly, these circumstances have led to a diversity of practices among contractors in calculating their material overhead rates. Legal research, however, indicates that this diversity has never been the source of litigation, possibly because the amounts involved were immaterial. In any event, it would appear that almost any methodology would be acceptable as long as it has a reasonably supportable basis and is consistently applied.

It is hoped that this article supplies all the information on material overhead government contractors may need for many years.

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Endnotes

1 - FAR 31.203(c).
2 - CAS 418-50(e)(1) and (e)(2).
3 - Cost Accounting Standard 418, Allocation of Direct and Indirect Costs.
4 - FAR 31.203(c).