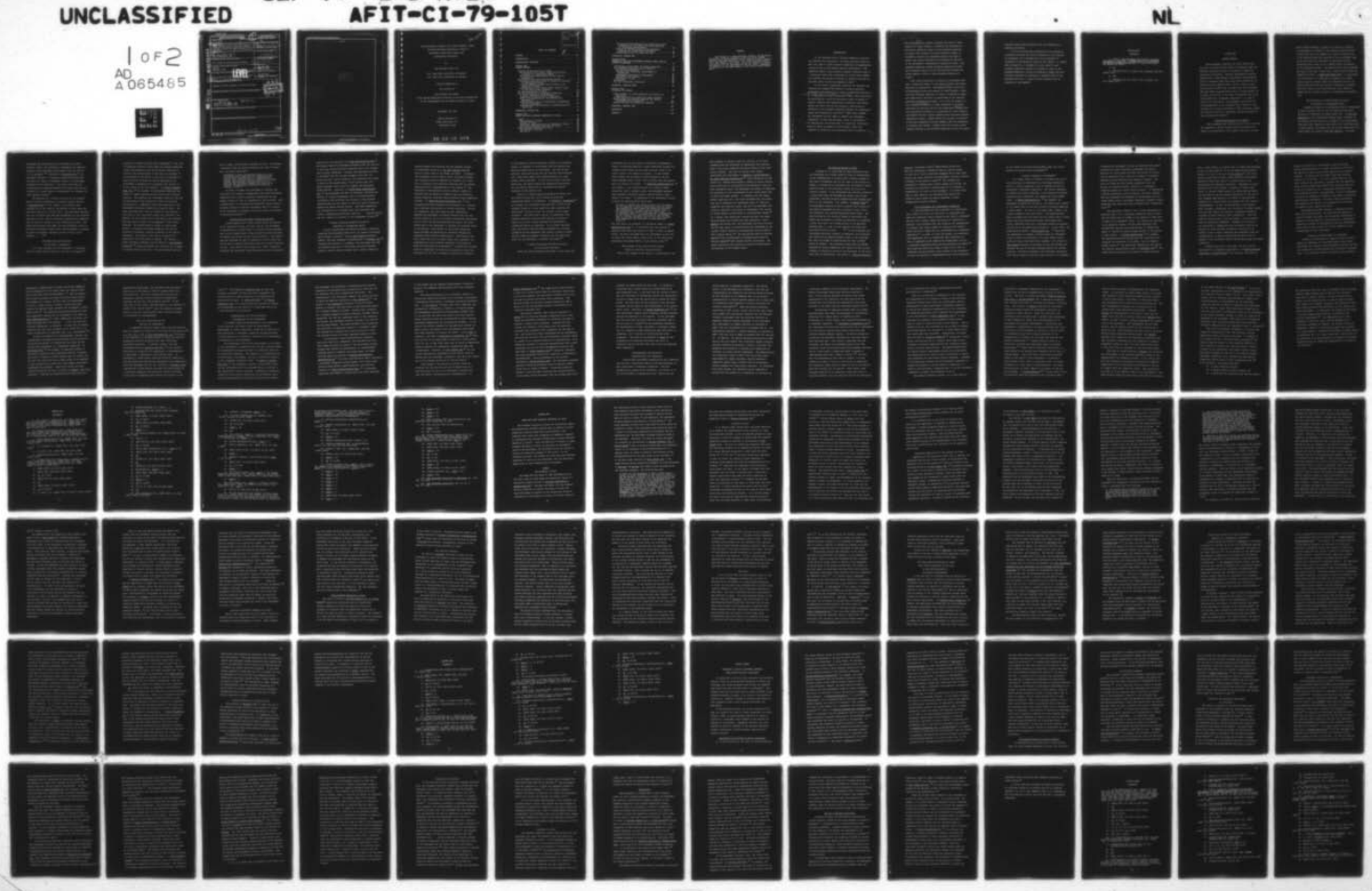
AD-A065 485 AIR FORCE INST OF TECH WRIGHT-PATTERSON AFB OHIO F/G 5/1
POST-ACCEPTANCE LIABILITY FOR LATENT DEFECTS, FRAUD AND GROSS M--ETC(U)
SEP 78 L B HOLT

UNCLASSIFIED AFIT-CI-79-105T NL

1 OF 2
AD
A065485




1.0
1.1
1.25
1.4
1.6
1.8
2.0
2.2
2.5
2.8
3.2
3.6
4.0
MICROCOPY RESOLUTION TEST CHART

UNCLASSIFIED

SECURITY CLASSIFICATION OF THIS PAGE (When Data Entered)

AD A065485

DDC FILE COPY

REPORT DOCUMENTATION PAGE

READ INSTRUCTIONS BEFORE COMPLETING FORM

1. REPORT NUMBER: CI 79-105T
2. GOVT ACCESSION NO.:
3. RECIPIENT'S CATALOG NUMBER:

4. TITLE (and Subtitle): ~~Thesis~~ Acceptance Liability for Latent Defects, Fraud and Gross Mistakes Amounting to Fraud in Government Fixed-Price Supply and Construction Contracts.

5. TYPE OF REPORT & PERIOD COVERED: (9) Master's Thesis, Thesis

6. PERFORMING ORG. REPORT NUMBER:

7. AUTHOR(s): (10) Lake Benjamin Holt, III

8. CONTRACT OR GRANT NUMBER(s):

(12) 125p.

9. PERFORMING ORGANIZATION NAME AND ADDRESS: AFIT student at the University of Georgia

10. PROGRAM ELEMENT, PROJECT, TASK AREA & WORK UNIT NUMBERS:

(11) 30 Sep 78

11. CONTROLLING OFFICE NAME AND ADDRESS: AFIT/CI, WPAFB OH 45433

12. REPORT DATE: Sept 30, 1978

13. NUMBER OF PAGES: 109, A-1 - A-12

14. MONITORING AGENCY NAME & ADDRESS (if different from Controlling Office): (14) AFIT-CI-79-105T

LEVEL II

15. SECURITY CLASS. (of this report): Unclassified

15a. DECLASSIFICATION/DOWNGRADING SCHEDULE:

16. DISTRIBUTION STATEMENT (of this Report)

Approved for Public Release, Distribution Unlimited

DDC RECEIVED MAR 8 1979 C

17. DISTRIBUTION STATEMENT (of the abstract entered in Block 20, if different from Report)

18. SUPPLEMENTARY NOTES

27 FEB 1979

JOSEPH P. HIPPS, Major, USAF
Director of Information, AFIT

19. KEY WORDS (Continue on reverse side if necessary and identify by block number)

20. ABSTRACT (Continue on reverse side if necessary and identify by block number)

012 200 JOB

DD FORM 1 JAN 73 1473 EDITION OF 1 NOV 65 IS OBSOLETE

UNCLASSIFIED

SECURITY CLASSIFICATION OF THIS PAGE (When Data Entered)

79-105T

Post-Acceptance Liability for Latent Defects, Fraud and Gross Mistakes Amounting to Fraud in Government Fixed-Price Supply and Construction Contracts

By

Lake Benjamin Holt, III

B.A. June 1968, University of Georgia

J.D. June 1973, University of Georgia

A Thesis submitted to

The Faculty of

The National Law Center

of The George Washington University in partial satisfaction

of the requirements for the degree of Master of Laws

September 30, 1978

Thesis directed by

Ralph Clark Nash, Jr.

Professor of Law

TABLE OF CONTENTS

PREFACE

The author is a Judge Advocate, Captain, United States Air Force, currently assigned to the Air Force Systems Command Plant Representative Office, Hughes Aircraft Corporation, Los Angeles, California. The views expressed herein are solely those of the author and do not purport to reflect the position of the Department of the Air Force, Department of Defense, or any other agency of the United States Government.

INTRODUCTION

In the everyday world of private commercial contracts for supplies and construction, the buyer generally does not have the right to insure contract compliance by comprehensive inspection and testing during contract performance.[1] The commercial buyer's main protection against defective work is a continuing right after acceptance to utilize basic common law remedies for breach of contract or remedies that may be available under the Uniform Commercial Code.[2]

In the world of Government contracts for supplies and construction, however, the method of insuring contract performance and protecting the buyer is radically different from private commercial contracts. It is the policy of the Government to obtain these objectives by establishing a specific contractual right to conduct or require intensive and comprehensive inspection and testing during the entire life of the contract. This policy is reflected in the standard Inspection clauses for fixed-price supply and construction contracts.[3] Under these clauses, the Government has the right to conduct any reasonable inspection, at any time and place, prior to acceptance.[4] In exchange for this broad right of inspection, the Government has given up almost all non-warranty rights and remedies for defective work discovered after acceptance. (cont'd p. 2)

The Government has, however, retained the right to seek redress for latent defects, or defects the acceptance of which were induced by fraud or gross mistakes amounting to fraud. The retention of these particular rights is intended to protect the Government against the type of defect that cannot ordinarily be discovered by exercise of the Government's comprehensive inspection rights. The standard Inspection clauses therefore generally provide that acceptance shall be final and conclusive except for latent defects, fraud, or gross mistakes amounting to fraud.[5]

The stated exceptions to finality of acceptance have been a continuous source of controversy between the Government and its contractors. This thesis examines the nature and meaning of latent defects, fraud, and gross mistakes amounting to fraud in fixed-price supply and construction contracts as established by the numerous decisions of boards and courts. It is also the purpose of this thesis to determine if these exceptions to finality have been an effective tool for the Government. Chapter One will therefore be devoted to a discussion of latent defects, and Chapter Two will closely examine fraud and gross mistakes amounting to fraud. Chapter Three will provide an overview of the most frequently utilized remedies when the exceptions to finality are invoked. Chapter Four will discuss recent proposed changes to the standard Inspection clause for supply

contracts which could radically alter the exceptions to finality provisions.

It is to be noted that defects which are covered by a warranty provision are also an exception to the finality of acceptance, but a discussion of such warranties is considered to be beyond the scope of this thesis. It should also be noted that a reference in this thesis to the standard Inspection clauses is intended to refer to the standard Inspection clauses of fixed-price supply and construction contracts as contained in Standard Form 32 and Standard Form 23-A. A copy of these standard forms is contained in the Appendix.

FOOTNOTES

1. Cibinic, The Government Non-Judicial Remedies for Breach of Contract: A Comparison of the Inspection and Default Clauses With the UCC, 34 George Washington Law Review 719 (1966).

2. Id.

3. Standard Form 32, Clause 5(a); Standard Form 23A, Clause 10(a).

4. Id.

5. Standard Form 32, Clause 5(d); Standard Form 23A, Clause 10(f).

CHAPTER ONE

LATENT DEFECTS

Post-acceptance liability for latent defects has been one of the most active areas of litigation under the standard Inspection clauses of fixed-price supply and construction contracts. Frequent controversy is partly explained by a large degree of subjective interpretation which is necessary under the latent defect definition of various contract appeal boards, and as a result of the heavy burden of proof that is placed upon the Government. The most widely accepted definition of a latent defect is a defect that exists at the time of acceptance and is not discoverable by a reasonable inspection.[1] In order to satisfy this definition, the Government must prove[2] by the preponderance of the evidence[3] that a defect in fact existed at the time of acceptance,[4] that the defect caused the failure,[5] and that a reasonable inspection would not have disclosed the defect.[6]

Proving the Existence of A Defect

The Government must initially prove that at the time of acceptance a defect existed within the meaning of a defect as established by the standard Inspection clauses.

These clauses establish a defect as a failure of material or workmanship in relation to the contract specifications.[7] A defect may exist for example as a result of design, but if the specifications are basically of the performance type and do not alert the contractor to operational design characteristics, there is not a defect within the meaning of the Inspection clause. The Armed Services Board stressed this point, and that a defect has a unique meaning under the Inspection clause, in Marmon-Herrington Inc.[8] In concluding that the failure of a compressor to operate over rough terrain was not a defect under the Inspection clause, the board generalized that the failure of material or workmanship must relate to the specifications, and a defect in design was not a defect related to a performance specification.

The Existence of a Defect Cannot Be Proven by Inference or Unsupported Theory

A defect in material or workmanship must be established by direct evidence and will not be inferred merely from failure of a structure or product during use. In R.E. Lee Electric Co.,[9] the Government offered expert testimony to the effect that the failure of a number of air conditioners could have been caused by a leaky seal which would have been a latent defect, and argued that the failure established the defect under the theory of res ipsa loquitur. The board

concluded that because there was testimony of several possible causes, "no inference or presumption of defective materials and workmanship arises merely from the failure of the equipment."[10] Similarly in Trio-Tech Inc.,[11] the Government relied on a continuous record of malfunctions and calls for repair to establish a defect in centrifuges furnished by the contractor. The board ruled that the circumstances of repeated breakdown and repair were not per se proof of a latent defect in consideration of evidence of other possible causes.[12]

The existence of a defect will also not be inferred merely from the introduction of possible expert theories. In Bromfield Corp.,[13] for example, only theories were presented as to the cause of the peeling of paint which the contractor applied to a ship's hull. The Government asserted that the contractor had used poor workmanship in not allowing the paint to cure, and the contractor asserted that chemicals used to contain a nearby oil slick affected the paint. The Armed Services Board concluded that the Government failed in carrying its burden of proof since "The Government is relying too much on plausible inference and too little on hard evidence . . . ."[14]

The Defect Must Have Existed at the Time of Acceptance

It is also necessary for the Government to establish that the latent defect existed at the time of acceptance[15]

and was not caused by events after acceptance.[16] The time of acceptance criteria arises from the standard Inspection clause establishment of the latent defect exception to finality and conclusiveness at the time of acceptance.[17] The existence of the defect at the time of acceptance is often difficult to prove but can be supported by the surrounding circumstances of acceptance and testing, or by the nature of the item supplied. In Triple A Machine Shop, Inc.,[18] for example, the Government contracted for repair of remote operating devices and aircraft fueling stations. The machinery was reasonably tested for one and one-half hours at the contractor's plant and operated satisfactorily. Immediately upon first operation at the Government's shipyard, defects were found to exist. The board concluded that "The only running of the machines took place at the contractor's plant and, therefore, the defects, by their nature had to have been in the machines when they were returned to the shipyard,"[19] and finally accepted. The unlikelihood of change in a particular product or structure following acceptance can also be utilized to establish a defects existence at the time of acceptance. The nature of the item or structure can demonstrate the unlikelihood of change. For example, a defect following acceptance was discovered in Gale Machine & Tool Co.,[20] during performance of a contract for a supply of tapered conical steel pins. The pins produced had too

great a taper and were thus unsuitable for use. In reaching a conclusion that the defect existed at the time of acceptance, the board stated that:

> Furthermore, since the supplies found to be nonconforming after inspection and acceptance were conical steel tapered pins of a cadmium plated finish, they are almost wholly impervious to change through environmental influences and are of a material and character whereby they would not be affected through abusive handling in shipment, storage, or use.[21]

In order to counter the Government's evidence, the contractor will attempt to demonstrate that events following acceptance are an equally plausible explanation for the subject failure or lack of conformance to the contract. Such a demonstration of alternate post-acceptance causes usually includes evidence of improper Government use,[22] or failure of the Government to properly protect the goods or structure or perform maintenance.[23]

Proving That The Defect Caused the Failure

Having proven that a defect exists within the meaning of the Inspection clause, the next step for the Government in establishing a latent defect is to prove by the preponderance of the evidence that a causal connection exists between the defect and failure of the item or structure. The Government may therefore be able to establish a latent defect but not be able to connect such defect with the claimed resulting failure. Just such a lack of proof of a causal connection prevented the Government from establishing the post-acceptance

liability of the contractor in Jo-Bar Manufacturing Corp.[24] The engines which the Government purchased under the contract in this case failed following acceptance due to oil seepage from cylinder assemblies. Although the Government was able to establish that the cylinder assembly walls were too porous and was a latent condition, the Government was unable to prove by the preponderance of the evidence that the porous cylinder walls caused oil seepage and subsequent engine failure. Similarly, in Tullar Power Construction, Inc.,[25] the Government was able to establish, following the failure of a power transformer, that an insulating block installed by the contractor was contrary to the contract specifications but was unable to prove the causal connection between the defect and the failure. The board summarized its conclusions in a statement that "The Government has proven a manufacturing deviation from the . . . specifications, but not a defect in relation to the transformer failure."[26]

A Causal Connection Cannot Be Proven by Inference or Unsupported Theory

As with establishing the defects existence, inferring causation from equipment failure will not sustain the Government's burden of proof.[27] The re ipsa loquitur approach, however, has been attempted as demonstrated in Datamark, Inc.[28] Following the failure of a computer, the Government was able to establish that part of the printer had been miswired. Unable to show by direct evidence that a causal connection

existed between the miswiring and the computer failure, the Government relied on a res ipsa loquitur approach since no other cause of the damage was shown. In denying the Government's latent defect claim, the board stressed that relying on such an approach was contrary to a clear line of authority that proximate causation must be clearly demonstrated by a preponderance of the evidence.[29] The Department of Transportation Board, however, appears to disagree with the weight of authority and has inferred a causal connection from mere failure without direct supportive evidence. In Ahern Painting Contractors, Inc.,[30] the Transportation Board examined the performance of a contract which concerned the painting of certain buildings. Following completion, the paint began to peel extensively. Although the Government introduced evidence that the contractor failed to use an oil primer, painted when the weather was too cold, and used non-specification paint, the board stated that it was impossible to identify the specific cause of the peeling, since neither of the parties presented expert evidence establishing any connection between the suggested causes and the peeling paint. Nevertheless, the board ruled that since no other causes were suggested, the preponderance of the evidence supported a conclusion of defective materials and workmanship.[31] Although this holding could be interpreted to stand for the proposition that the Government may be able to establish causation by inference

in the absence of direct contractor evidence of alternative causes, it probably is reconcilable with the general rule when the unusual facts are considered. The defects were multiple, gross deviations from the contract specifications and a type which common sense would recognize as a very likely cause of peeling. In the face of silence from the contractor, the board reached the appropriate conclusion, but the holding should only be considered an unusual exception to the general rule.

Proof of a casual connection between the defect and the item's failure must also be based on more than unsupported theory or assumptions. In Richard F. Greenhaugh,[32] for example, the Government theorized that a crack in the concrete lining of a ditch could have been caused by the contractor's failure to pour the concrete to the proper thickness. The contractor's ability to hypothesize that cracking could have resulted from failure of design or nature of the soil, easily defeated the Government's unsupported theory of causation. In an almost identical case, the General Services Board concluded that the mere assumption by the Government that cracks in plastic chairs must be caused by improper thickness, was not sufficient proof for the Government to sustain its burden.[33]

A Causal Connection Need Not Be Proven To an Absolute Certainty

While the above discussed cases make it clear that the

Government may not rely alone on inference or unsupported theory to establish proof of a causal connection between the claimed latent defect and the item's failure, there is no need of proof to an absolute certainty. If the claimed latent defect can be shown by direct evidence to be the "most probable cause" of the item's failure, then the Government will sustain its burden. In Jefferson Construction Co.,[34] for example, a case involving proof of a similar causal connection under a guaranty claim, the Government asserted that irregular insulation around a buried electric cable caused it to break. In commenting on the Government's burden of proof the Armed Services Board held:

> In order to sustain the burden of proof the Government is not required to prove an absolutely positive connection between the cable breaks and defective materials and workmanship or to prove that the breaks could not possibly have resulted from any other cause. It is sufficient that it is established by a preponderance of the evidence that defective material and workmanship is the most probable cause of the cable failures when considered with reference to other possible causes.[35]

The same theory was restated in a different manner in Jo-Bar Manufacturing Corp.[36] In concluding that the failure in question could have been caused by either a latent or patent defect, the board concluded that the "Government is not free to pursue the latent defect theory until it has effectively discredited the patent defect as the primary cause."[37]

Relationship of the Latent Defect Caused Injury to the Total Injury Suffered

Even if the claimed latent defect is established as the

most probable or primary cause of a failure, it is still incumbent upon the Government to demonstrate the relationship of the injury caused by the latent defect to the total injury suffered. The Court of Claims first clearly established this requirement in Roberts v. United States & The Great American Insurance Co.[38] After demonstrating that cracks in a roadway were primarily caused by certain defects which could only be ascertained by the passage of time and were considered latent, the Government was unable to establish the proration of cost attributable to the latent defect and to other non-latent defects. In deciding that the latent defect claim must fail, the court concluded that the Government had to establish the fundamental facts of liability, causation and resultant injury, and that the Government had failed to establish a proration of replacement cost caused by latent defects, patent defects, and Government design.[39] In a similar case concerning a paving contract, the Armed Services Board also reached the same conclusion, citing Roberts and stating that "the Government has given no basis for how much repair or reconstruction was attributed to the claimed (latent) defects as distinguished from the Government's faulty design."[40] The Agriculture Board of Contract Appeals[41] and the Department of Transportation Board of Contract Appeals[42] have reached similar conclusions. The causal connection must therefore clearly be established in relationship to the claimed injury.

The Shifting Burden of Proof

Although it is clear from the above discussion that the Government has a heavy burden of proof in establishing by the preponderance of evidence that a defect existed at the time of acceptance and was the cause of the failure or damage, it should not be concluded that the burden of proof does not shift to the contractor during the trial of a contract dispute. If the Government can initially establish a prima facie case and overcome the initial risk of non-persuasion, the duty of going forward with the evidence will shift to the contractor. For example, in Admiral Corp.[43] the Government asserted by direct evidence that failure of the supplied equipment was due to defective parts; while the contractor only asserted unsubstantiated causes. The board pointed out the shifting burden by concluding that should the Government's evidence be sufficient to establish a prima facie case, the "burden shifts to the appellant imposing upon it a duty to come forward with proof that such defects did not exist. . . ."[44] If the Government has introduced sufficient evidence on causation, the contractor must establish an equally probable cause or the Government may carry its burden of establishing the "most probable cause" by default. The contractor cannot meet his burden therefore by merely suggesting like causes; he must present evidence as equally as strong as the Government if the prima facie case is established. The board in Jefferson Construc-

tion Co., previously cited,[45] specifically pointed out that the contractor's conclusion that his job was simply to show that a failure could have happened due to many other things than causes stated by the Government, was not a correct statement of the burden of proof.[46] The stronger the Government's evidence that a defect caused the failure, the stronger the contractor's evidence must be to eliminate a preponderance in favor of the Government. If a prima facie case is weak, however, the contractor may sustain his burden of going forward by merely asserting a theory unsupported by direct evidence.

Not Discoverable by A Reasonable Inspection

If the Government has been successful in establishing that a defect for which the contractor is responsible for under the Inspection clause existed at the time of acceptance, and that such a defect caused the failure or condition in question, the Government must also prove by the preponderance of evidence that unique element of latency which requires proof that such a defect was not discoverable by a reasonable inspection.[47] In order to carry this burden, the Government must demonstrate how its inspections were conducted, how such an inspection would normally be accomplished, and why a reasonable inspection would not have disclosed the defect.[48] The boards and courts have taken a broad view of what is reasonable and have placed a heavy burden on the Government as their conclusions of reasonableness have varied depending

on the nature of the particular product under the circumstances of the particular procurement.[49]

A Visual Inspection Is Reasonable

If a defect which is claimed to be latent can easily and practically be discovered by an ordinary examination such as a visual inspection, such an examination will be considered a reasonable inspection. The failure therefore to conduct the visual inspection, or to discover the defect through such an inspection, will defeat the latent defect claim. In Royson Engineering Co.,[50] for example, the Government asserted that the use of .30 carbon steel instead of .40 carbon steel on the end fittings of missile bands was a latent defect. The use of .30 carbon steel, however, was clearly stamped on each end fitting. The Armed Services Board concluded that the defect was not latent since it could easily have been ascertained without undue effort by a visual inspection which was a reasonable method of discovering the use of non-specification material. A year later, the Armed Services Board, in Dale Ingram, Inc., [51] again had the opportunity to examine a dispute where the Government tried to assert the existence of a latent defect which a practical visual test would have revealed. The contract in Dale Ingram concerned the building of military housing and required the use of five-ply mahogany plywood for roofing material. Following acceptance, the Government discovered that various types of wood were used instead of all mahogany.

In denying the Government's claim, the Armed Services Board stressed that expert testimony established the ease of detection by visual means, and that the failure to utilize such an examination was a failure to conduct a reasonable examination which destroyed any element of latency. The Court of Claims has also clearly established that the ability to visually discover a defect is a reasonable inspection within the latent defect criteria. In considering a dispute concerning a paving contract, the court reasoned that the unevenness and roughness of the pavement was not a latent defect since a reasonable inspection included a visual inspection that would have easily revealed such "preceptible flaws."[52]

The conclusion, however, that a visual examination is generally held to be a reasonable inspection does not mean that the defect must be hidden or not capable of being seen in order to be considered latent. For reasons not justified in the opinions, however, various board decisions have confused the issue by using such phrases as "hidden from sight" or "having an inherent hidden nature" in discussing a latent defect. In Milton Machine Corp.[53] for example, the Armed Services Board stated that the "Government must establish the existence of the defect, and its inherent hidden nature."[54] The exact same language was utilized by the Veterans Administration Board in Trio-Tech, Inc.[55] The Armed Services Board has also stated in several opinions

that a latent defect is a defect that is hidden from knowledge as well as from sight.[56] It was the Armed Services Board, however, in 1957 in the case of F.W. Lang Co.[57] that first clearly established the most widely accepted latent defect definition which only refers to a defect which is not discoverable by reasonable inspection. Subsequent to those decisions that have included a reference to hidden from sight, or inherent hidden nature, the Armed Services Board has continued to use the standard definition.[58] The use of such language adds nothing to an effort to determine the existence of a latent defect and confuses the true issue of reasonableness. In fact, an examination of the opinions which included a requirement that the defect be hidden reveals that the real inquiry was whether a reasonable inspection included an easily applied visual examination. Since the defects could be seen or were not hidden, a visual examination was considered reasonable. Although the failure of the Government to demonstrate that the defect could not be detected by sight may have influenced a decision as to whether or not a visual inspection was reasonable under the circumstances, it did not resolve the ultimate issue of whether or not the defect could be discovered by any reasonable inspection.

A defect may be out in the open, but still not be detectable by a reasonable examination. In Kaminer Construction Corp. v. United States,[59] for instance, the Court of

Claims was faced with a latent defect claim concerning sixteen undersized bolts in a tower containing 11,967 bolts. The failure of these sixteen bolts resulted in the tower's collapse. The bolts were not hidden from sight and were clearly out in the open. In a well reasoned opinion, the court rejected the contractor's argument that the undersized bolts were not hidden from sight[60] and, utilizing only the criteria of whether or not a reasonable inspection would have revealed the bolts, concluded that it was not reasonable to require an inspector to examine 11,967 bolts to determine specification conformance. The court clearly recognized the ultimate issue and was not persuaded by the fact that the defect was not hidden from sight.

The hidden-from-sight criteria is ambiguous and has been often misinterpreted. No matter how the boards are utilizing hidden from sight, the traditional examination of whether or not the defect is discoverable by a reasonable inspection includes any consideration that the hidden-from-sight criteria might invoke and is more adaptable to the circumstances of each procurement.

Inspection by Measurement Is Reasonable

Defects in construction or supplies which are dimensional are generally not considered latent since simple measurement will usually reveal dimensional defects and thus are considered to be discoverable by an ordinary reasonable test. In a very early decision concerning latent defects,

dimensional irregularities in torque tube-drive assemblies were considered not to be latent since the defects could easily have been found by measurement. [61] When the Government failed to measure the depth of working joints during the pavement of a runway, the fact that such measurement by use of a knife, pencil, or ruler, could easily have revealed an improper depth, defeated the Government's latent defect claim.[62] The Armed Services Board affirmed the view that dimensional defects are not considered to be latent in Platt Manufacturing Co.[63] After summarizing the facts, the board concluded that "the defects . . . here involved were basically dimensional in character. We have held on several occasions that this type of defect is not latent for it is easily discoverable by reasonable test, i.e., measurement."[64]

As with all questions of reasonableness, however, the circumstances surrounding the procurement and the nature of the particular product or construction can alter the conclusion that measurement is a reasonable inspection. In Cross Aero Corp.,[65] for example, an important element in the board's conclusion that dimensional defects in knuckle pins used to overhaul aircraft engines were not latent, was the fact that there were only a small number to be measured. A clear indication was given that large numbers would make measurement unreasonable. This was of course the exact situation faced by the Court of Claims in Kaminer, previously discussed. Although the undersized bolts could have been

discovered by measurement, the Government may have had to measure all 11,967 bolts to find the sixteen bolts that were defective. The court reasoned that this was not a reasonable inspection since no special circumstances indicated the need for such extensive testing. As the court was to later state, "The Government is not required to inspect every routine task"[67] under the Inspection clause. Clearly, practical considerations have a strong influence in the search for reasonableness.

Tests and Inspections in the Contract are Reasonable

A reasonable inspection almost always includes specific tests or inspections called for by the terms of the contract.[68] In a few cases, such as Tecan-Green-Winston, Inc.,[69] failure of the contractor to properly prepare or allow for contract-designated tests has prevented such tests from being considered reasonable. In general, however, the rule established early by Gordon H. Ball Inc.,[70] that contract provisions for inspection are guidelines of reasonableness, is applicable in appropriate latent defect cases. In considering a latent defect claim for defective welds which were detectable by contractually designated X-ray examinations which the Government did not use, the board in Gordon H. Ball reasoned that "Latent defects are those not discoverable by a reasonable inspection and obviously a defect detectable by the kind of inspection specified by the contract is not

latent."[71] The holding of Gordon H. Ball has been consistently followed[72] and has even been incorporated into the definition of latent defect on two occasions by the Armed Services Board. In Cross Aero Corp.[73] and Herley Industries, Inc.,[74] a latent defect was defined as a defect not discoverable by the exercise of reasonable care or by a test specified in the contract.

Reasonableness and the Surrounding Circumstances of the Procurement

If a defect cannot be discovered by a test specified in the contract, and cannot easily be discovered by measurement or visual examination, answering the question of what constitutes a reasonable inspection becomes much more a direct function of a subjective analysis of the surrounding circumstances of the procurement.

The background of the varied procurements is one aspect of the surrounding circumstances that can have a direct effect on establishing the type and extent of inspection that will be considered reasonable. The experience or inexperience of the contractor, for example, can have a significant bearing on the reasonable inspection issue. In Triple A. Machine Shop, Inc.,[75] the Government claimed a latent defect which was not discovered prior to acceptance during a one hour a day inspection of work in progress. Although the contractor argued that this limited inspection was unreasonable and a more thorough examination would have discovered the defect,

the Government was successful in establishing that minimum inspection was reasonable when contracting for work that was not difficult for such an experienced contractor. The inexperience of the contractor, however, was partly utilized to reach the opposite conclusion in T.M. Industries.[76] The dispute in T.M. Industries concerned a claim for latent defects in tractors that were built to specifications geared to a standard commercial product. Knowing that a contract for a standard commercial product generally included limited inspection, and that the experience level of the contractor was unclear, the Government failed to include first article testing requirements. The board concluded that considering the particular circumstances involved, a reasonable inspection should have included first article testing or rigid and thorough testing of actual completed production units.

The inclusion of detail specifications requiring particular materials, components, and tolerances has also been viewed as being one aspect of the surrounding circumstances that affects the determination of reasonableness. Although stated in somewhat over-broad terms, the Armed Services Board has reasoned in Hercules Engineering & Manufacturing Co.[77] that when specifications detail tolerances, a reasonable inspection should include a test which would discover those defects deemed sufficient for rejection. Similarly in Geranco Manufacturing Corp.,[78] a reasonable inspection was deemed to include tests that would determine

if the product met the extensive requirements of detailed material and component specifications which the Government required.

The custom and practice of a particular industry in testing and inspection has been one of the basic surrounding circumstances which affect a reasonable inspection determination. In F.W. Lang Co.,[79] where after final inspection and acceptance of refrigerators a defect in a strainer system was subsequently detected by the Government through X-ray, it was held that the defect was latent since this type of defect ordinarily could not be discovered by normal testing procedures conducted by the refrigeration industry. It was found to be neither customary nor economically feasible to make X-rays of all parts of the refrigerators which would have been necessary to discover the defect. Citing Lang as authority, the board in Harrington & Richardson, Inc.[80] held that the use of the wrong type of steel was a latent defect since the use of such steel could only be found by complicated chemical analysis not customarily accomplished under the circumstances. Similarly, in Dale Ingram, Inc.[81] the contractor defeated the Government's latent defect claim by showing that the Government conducted a test which was customary in the industry and failed to find the defect.

Even though a test may not be used by custom or practice, the availability and ease of application of a particular test is one of the surrounding circumstances that can affect a determination of reasonableness. In

Herley Industries, Inc.,[82] the Armed Services Board denied a claim for a latent defect when the contractor proved that a particular chemical test was easily available and in fact was used to discover the defect after acceptance. The decision stands for the well accepted proposition that a defect will not be considered latent if discovered by an ordinarily available test.

Contractors, however, have cited the decision in Herley for the entirely different proposition that a test should be considered reasonable if ultimately utilized to discover a defect after acceptance. Although the conclusion was reached in the decision that an ordinarily available test conducted after acceptance was the type of test that should have been accomplished during performance, the board did not state that post-acceptance testings should be looked to as a general guideline of reasonableness. Even though the validity of assessing reasonableness from a post-acceptance test has not been subsequently clarified, the same board in Milton Machine Corp.[83] indirectly indicated that post-acceptance testing was irrelevant in determining reasonableness. During performance of the contract considered in Milton Machine Corp., the Government conducted specified visual and penetrant tests of numerous welded joints with no signs of defects. Following acceptance, however, a more stringent vibration test produced failure of the welds, and an ultrasonic test was accomplished which

revealed the latent defect as the cause. In reaching a conclusion that a latent defect was established by the post-acceptance test, it was held that the nature of such a test was irrelevant in determining whether the contractor's failure to comply with the specification caused the latent defect. The fact that the post-acceptance test was more stringent had no effect on the establishment of the latent-defect claim. Similarly, in Royson Engineering Co.,[84] the Navy discovered a defect after acceptance through extensive testing not specified in the contract. It was concluded that the test went far beyond what was reasonable and it was not used as a standard for pre-acceptance inspection. The determination of what constitutes a reasonable inspection is a question of what should have been done prior to acceptance, not a function of actual practice after acceptance. The basis of the decision in Herly was the existence of an ordinarily available test prior to acceptance and not the fact that such a test was conducted after acceptance.

Reasonableness and Contractor Responsibility for Inspection

Contractually designated responsibility for inspection has also had a significant impact on the determination of what constitutes a reasonable inspection. The more responsibility placed on the contractor, the easier it is for the Government to demonstrate that a defect was not

discoverable by a reasonable inspection. The general policy of the Government has reflected a view that the responsibility for inspection and testing should be shared by the contractor as an essential part of his overall responsibility to control product quality and to only offer for acceptance those supplies or services that meet the contract requirements.[85] Under the Quality Assurance provisions of ASPR 14-302, 14-303, and 14-304, most fixed-price supply and construction contracts over $10,000 must include a requirement that the contractor maintain an adequate inspection system acceptable to the Government. This requirement for supply contracts is reflected in ASPR 7-103.5(e) and Section 5(e) of Standard Form 32. For construction contracts, a similar provision is required by ASPR 7-602.10(a) and is added to Standard Form 23A, Section 10. In addition, the Quality Assurance provisions of ASPR Section XIV also require that fixed-price supply contracts, and most construction contracts, contain a provision that obligates the contractor to perform such inspections as necessary to insure contract compliance. The Responsibility for Inspections clause of ASPR 7-103.24 provides such a requirement for supply contracts, and the Contractor Inspection System clause of ASPR 7-602.10 incorporates similar language for construction contracts. In accordance with these clauses, the contractor may be required to certify that the product he is supplying, or structure he

is building, complies with the contract requirements. The Federal Procurement Regulations similarly provide in Part 1-14 for quality assurance provisions that affect responsibility for inspection, but such provisions are considerably less detailed and comprehensive than those provided in the Armed Services Procurement Regulations.[86]

Certificates of compliance issued under the clauses described above may enable the Government to successfully establish that a defect which is effected by such a certificate is a latent defect, even though discoverable by a reasonable inspection. In Harrington & Richardson, Inc.[87] the contractor certified that certain steel was in conformance with the contract specifications which could have been verified through chemical analysis. Following acceptance, testing by the Government indicated that the wrong type of steel had been used. Even though a reasonable test was available, the defect was considered latent since "the existence of the contractually specified procedure requiring use of a certificate of compliance tends to negate an understanding that such a defect is patent."[88] The fact that the Government has the right to inspect in no way affects its right to rely on a certificate of compliance. The Inspection clause does not impose a duty on the Government and is solely for its benefit. Even though a more thorough exercise of its inspection rights may reveal a particular defect, this fact does not relieve the contractor

of its responsibilities under a contractually provided certification of compliance.[89]

Even if a certificate of compliance is not required, the Responsibility for Inspection clause or the Contractor Inspection System clause alone can significantly affect a determination of what constituted a reasonable inspection by placing the inspection responsibility on the contractor. The Armed Services Board first indicated this relationship in the 1958 decision of Polan Industries, Inc.[90] It was held that the contractor was obligated to make certain tests in terms of custom and usage of the industry. Having refused to do so, the contractor was not allowed to successfully argue against the existence of a latent defect which such tests might have disclosed. Subsequently, the Armed Services Board in Irving Air Chute Co.[91] considered a latent defect claim pertaining to a contract which specifically included a contractor Responsibility for Inspection clause within a military specification. The board reasoned that the quality control requirements placed on the contractor the responsibility for quality control sufficient to assure that production met contractual quality standards. Although it was physically possible for the Government inspectors to examine the product at certain stages of production, in light of the contractor's responsibility it was not considered reasonable to require the Government to do so.

The question remained, however, as to what would be

considered a reasonable inspection for the Government to conduct when the basic responsibility is placed on the contractor. The Court of Claims concluded in Kaminer Construction Corp. v. United States[92] that a reasonable inspection only includes that which is necessary to discover an obvious error. The contract in Kaminer contained the Contractor Inspection System clause for construction contracts as contained in ASPR 7-602.10. Under this provision, the contractor had the primary duty to perform such inspections as were necessary to assure that work performed was in accordance with contract requirements. Considering this placement of responsibility, the board concluded that "only the failure of the Government to discover an obvious error in construction would have relieved plaintiff of its responsibility to insure that the tower and derricks were properly constructed."[93] Sixteen defective bolts in a 11,967 bolt structure was considered "hardly an obvious discrepancy."[94] Under similar contractual provisions, a defect which is not obvious would therefore not be considered latent. This could have a significant favorable impact on the ability of the Government to establish a latent defect claim. What is an obvious error, of course, is subject to a wide range of interpretations. The Armed Services Board, at least, appears to interpret an obvious error broadly. In Conrad Weihnacht,[95] a latent defect claim for defective welds was asserted by the Government under a

contract which contained a Responsibility for Inspection clause. In rejecting the latent defect claim, it was held that although a visual inspection would not have revealed a lack of penetration in the welds, it would have shown poor workmanship which caused the lack of penetration. The poor workmanship was found to be an "obvious error in construction" which should have been found. Although Kaminer was distinguished on that basis, there does not appear to be the type of obvious error which Kaminer would require in order to place a greater requirement for inspection on the Government. Poor workmanship may have been obvious, but the specific defect of poor penetration of welds was not. Notwithstanding the broad view of the Armed Services Board concerning obvious errors, the Kaminer decision still stands for the significant proposition that when contractor responsibility for inspection is present, reasonable inspection under the latent defect definition is only that which is necessary to find an obvious defect.

The Court of Claims decision in Kaminer also clarifies the relationship of the standard Inspection clause to the Responsibility for Inspection clause. It was clearly held that the contractor's obligation to perform the necessary inspections is not eliminated by the Government's ability to inspect under the Inspection clause. The existence of the right in no way imposed a duty on the Government.[96] The Armed Services Board has specifically followed this rationale

in the recent decision of RFI Shield-Rooms.[97] It has also now been incorporated into the language of the Responsibility for Inspection clause in ASPR 7-103.24. The current clause states that the contractor must perform all needed tests "notwithstanding the requirements for any Government inspection and test contained in specifications applicable to this contract, except where specialized inspections or tests are specified for performance solely by the Government." As the clause indicates, however, if there are tests to be performed by the Government, such tests will be considered reasonable under the latent defect definition even when a contractor Responsibility for Inspection clause is included.[98]

The trend in Government procurement is to place more inspection responsibility upon the contractor through appropriate quality assurance provisions. In addition to the evidence of such a trend previously discussed,[99] the Defense Logistics Agency is also currently conducting a test program to continue into 1980 that places a greater reliance on the contractor's own quality control system. The specific purpose of the test is to establish whether Government inspectors can be removed from high quality contractors and be placed in more troublesome areas.[100] To be included, a contractor must have:

(1) A source inspection system

(2) A superior quality control program, and

(3) A reputation for delivering high quality products

The contractor would then sign an agreement with the Defense Contract Administration Service that he will maintain a high level of quality control. He will be permitted to assess his own product quality as long as quality remains high, defects are promptly corrected, and schedules are met. The current participating contractors are RCA, Bendix and Texas Instruments. If successful, the program would expand to non-DCAS administered contracts controlled by the military departments.[101] The implementation of such a program on a permanent basis, and the expanded use of contractor inspection in general, can directly affect the Government's ability to successfully assert the existence of a latent defect. Although the Government's burden remains a significant one, it is more likely that a defect will not be considered to be discoverable by a reasonable Government inspection when the inspection responsibility is placed on the contractor.

CHAPTER ONE

FOOTNOTES

1. F.W. Lang Co., ASBCA 2677, 57-1 BCA ¶ 1334 (1957); Hercules Engineering & Manufacturing Co., ASBCA 4979, 59-2 BCA ¶ 2426 (1959); T.M. Industries, Inc., ASBCA 19068, 75-1 BCA ¶ 11,056 (1975); Metalstand Co., GSBCA 4682, 77-1 BCA ¶ 12,418 (1977).

2. Geranco Manufacturing Corp., ASBCA 12376, 68-1 BCA ¶ 6898 (1968); Keco Industries, Inc., ASBCA 13271, 71-1 BCA ¶ 8727 (1971); Southwest Welding & Manufacturing Co. v. United States, 188 Ct. Cl. 925, 413 F.2d 1167 (1969).

3. Jo-Bar Manufacturing Corp., ASBCA 18292, 73-2 BCA ¶ 10,353 (1973), Metalstand Co., GSBCA 4682, 77-1 BCA ¶ 12418 (1977).

4. J.W. Bateson Co., FAACAP 66-25, 66-1 BCA ¶ 5479 (1966).

5. Trio-Tech, Inc., VACAB 598, 68-1 BCA ¶ 6828.

6. United Electronics Co., ASBCA 15825, 72-2 BCA ¶ 9642 (1972).

7. Standard Form 23A, Clause 10(b); Standard Form 32, Clause 5(b); Dale Ingram, Inc. ASBCA 12152, 74-1 BCA ¶ 10,436 (1974); H. Bendzulla Contracting, Inc., ASBCA 18588, 74-2 BCA ¶ 10,690 (1974).

8. ASBCA 10889, 67-2 BCA ¶ 6523 (1967).

9. GSBCA 1040, 1964 BCA ¶ 4401 (1964).

10. Id. at 21,252.

11. VACAB 598, 68-1 BCA ¶ 6828 (1968).

12. Id.

13. ASBCA 16968, 73-2 BCA ¶ 10357 (1973).

14. Id. at 48,913.

15. A. Brown & Co., GSBCA 3575, 73-2 BCA ¶ 10,219 (1973).

16. Marmon-Herrington Co., supra n. 8.

17. Standard Form 23A, Clause 10(f); Standard Form 32, Clause 5(d).

18. ASBCA 16844, 73-1 BCA ¶ 9826 (1973).

19. Id. at 45924

20. ASBCA 13954, 69-2 BCA ¶ 7880 (1969).

21. Id. at 36,656.

22. Supra n. 5.

23. LTV Electro Systems, Inc., ASBCA 16106, 72-2 BCA ¶ 9669 (1972).

24. Supra n. 3.

25. IBCA 633-4-67, 69-2 BCA ¶ 7829 (1969).

26. Id. at 36,384.

27. Tuller Power Construction, Inc., supra n. 25.

28. ASBCA 12767, 69-1 BCA ¶ 7464 (1969).

29. Id.

30. DOTCAB 67-7, 68-1 BCA ¶ 6949 (1968).

31. Id.

32. AGBCA 315, 74-1 BCA ¶ 10,581 (1974).

33. Metalstand Co., supra n. 1.

34. ASBCA 7008, 1962 BCA ¶ 3409 (1962).

35. Id. at 17,494.

36. Supra n. 3.

37. Id. at 48,899.

38. 174 Ct. Cl. 940, 357 F.2d 938 (1966).

39. Id.

40. Rand Construction Co., ASBCA 14891, 72-1 BCA ¶ 9441 (1972), at 43,858.

41. Richard F. Greenhaugh, supra n. 32.

42. C.W. Roen Construction Co., DOTCAB 75-43, 75-43A, 76-2 BCA ¶ 12,215 (1976).

43. DOTCAB 70-2, 71-2 BCA ¶ 9098 (1971).

44. Id. at 42,160.

45. Supra n. 34.

46. Id.

47. F.W. Lang Co., supra n. 1; Hercules Engineering & Manufacturing Co., supra n. 1; T.M. Industries, Inc., supra n. 1; Metalstand Co., supra n. 1.

48. Geranco Manufacturing Corp., supra n. 2.

49. Herley Industries, Inc., ASBCA 13727, 71-1 BCA ¶ 8888.

50. ASBCA 15438, 15734, 73-2 BCA ¶ 10,229 (1973).

51. Supra n. 7.

52. Joseph H. Roberts v. The United States, supra n. 38, at 955.

53. ASBCA 15397, 72-1 BCA ¶ 9203 (1972).

54. Id. at 42,702.

55. Supra n. 5.

56. LTV Electro Systems, Inc., supra n. 27; Cottman Mechanical Contractors, Inc., ASBCA 11387, 67-2 BCA ¶ 6566 (1967); Cross Aero Corp., ASBCA 14801, 71-2 BCA ¶ 9075 (1971).

57. Supra n. 1.

58. Dale Ingram, Inc., supra n. 7; Stewart Avionics, Inc., ASBCA 15512, 15893, 75-1 BCA ¶ 11,253 (1975); T.M. Industries, Inc., supra n. 1.

59. 203 Ct. Cl. 182, 488 F.2d 980 (1973).

60. The same conclusion was reached in Herley Industries, Inc., ASBCA 13727, 71-1 BCA ¶ 8888, where the board stated at 41309 that "The determinative factor in ascertaining latency is whether or not the defect could be discovered

by ordinary and reasonable care. The fact that it may be hidden from sight . . . does not preclude obtaining knowledge thereof by tests which should have been considered or applied under the circumstances."

61. Hercules Engineering & Manufacturing Co., supra n. 1.

62. Federal Construction Co., ASBCA 17599, 73-1 BCA ¶ 10,003 (1973).

63. ASBCA 19906, 76-2 BCA ¶ 12,016 (1976).

64. Id. at 57,641.

65. Supra n. 56.

66. Kaminer Construction Corp., supra n. 59.

67. Penguin Industries, Inc. v. United STates, 209 Ct. Cl. 121, 124, 530 F.2d 934 (1976).

68. Gordon H. Ball, Inc., ASBCA 8316, 1963 BCA ¶ 3925 (1963).

69. ENGBCA, 2704, 67-1 BCA ¶ 6148 (1967).

70. Supra n. 68.

71. Id. at 19,478.

72. Stewart Avionics, Inc., supra n. 58; A. Brown & Co., supra n. 15; Southwest Welding & Manufacturing Co., supra n. 2; Royson Engineering Co., supra n. 50.

73. Supra n. 56.

74. Supra n. 49.

75. Supra n. 18.

76. Supra n. 1.

77. Supra n. 1.

78. Supra n. 2.

79. Supra n. 1.

80. ASBCA 9839, 72-2 BCA ¶ 9507 (1972).

81. Supra n. 7.

82. Supra n. 49.

83. Supra n. 53.

84. Supra n. 50.

85. ASPR 14-102(a); FPR 1-14.104(a)(b)(c); DOD Directive 4155.1 dated Feb. 9, 1972.

86. FPR 1-14.101; FPR 1-14.104(a)(b)(c).

87. Supra n. 80.

88. Id. at 44,296.

89. Jo-Bar Manufacturing Corp., ASBCA 17774, 73-2 BCA ¶ 10311 (1973); Kenneth Reed Construction Corp. v. United States, 201 Ct. Cl. 282, 475 F.2d 583 (1973); Penquin Industries v. United States, supra n. 67.

90. ASBCA 3996, 58-2 BCA ¶ 1982 (1958).

91. ASBCA 6667, 1963 BCA ¶ 3917 (1963).

92. Supra n. 59.

93. Id. at 195.

94. Id. at 195.

95. ASBCA 20767, 76-2 BCA ¶ 11,963 (1976).

96. Supra n. 59.

97. ASBCA 19038, 77-1 BCA ¶ 12,237 (1977).

98. Stewart Avionics, Inc., supra n. 62.

99. Supra n. 85.

100. The Government Contractor's Communique, No. 78-4, Feb. 10, 1978.

101. The Government Contractor, Vol. 20, No. 5, Feb. 27, 1978.

CHAPTER TWO

FRAUD AND GROSS MISTAKES AMOUNTING TO FRAUD

The standard Inspection clauses for fixed-price supply and construction contracts provide that in addition to post-acceptance liability based upon latent defects, such liability also exists when acceptance of defective supplies or construction has occurred through fraud or gross mistakes amounting to fraud.[1] Since the assertion of fraud, or gross mistakes amounting to fraud, is generally an affirmative claim by the Government, the Government bears the burden of proving the essential elements of the claim.[2] In the following sections, the elements of fraud and gross mistakes amounting to fraud will be established, and the decisional application of these elements will be analyzed.

Fraud

The Elements of Proof

The Armed Services Board in 1959 considered one of the first cases of fraud under the Inspection clause of a fixed-price supply contract in Hercules Engineering & Manufacturing Co.[3] Although concluding that the evidence was not sufficient to sustain the claim of fraud, the board did appear to approve of the contracting officer's indication of the elements of fraud in his final decision.

The contracting officer's final decision stated that the "Said defects constituted concealment, which should have been disclosed and which was intended to deceive and did deceive, and as a result of such deception, the Government accepted supplies with defects to its detriment."[4] The board appeared to agree that fraud would be proven under the Inspection clause if the Government could establish that as a result of intentional deception by concealment and misrepresentation, the Government accepted defective goods to its detriment. Similarly, the Court of Claims concluded in a footnote to its decision in Bar-Ray Products, Inc. v. United States,[5] that to establish fraud under the Inspection clause "it is necessary to show misrepresentation of a material fact, an intent to deceive, and reliance on the misrepresentation by the other party to his detriment."[6] In the more recent decision of Dale Ingram, Inc.,[7] the Armed Services Board combined the elements of fraud discussed in Hercules and Bar-Ray and issued a clear delineation of the necessary elements. The board stated that:

> In order for the Government to have a legal right to revoke its final acceptance on the ground of fraud, it has the burden of proving (1) that its acceptance was induced by its reliance on (2) a misrepresentation of fact, actual or implied, or the concealment of a material fact, (3) made with knowledge of its falsity or in reckless and wanton disregard of the facts, (4) with intent to mislead the Government into relying on the misrepresentation, (5) as a consequence of which the Government has suffered injury. 12 Williston, Contracts, (3d ed.), Section 1487A. All of these elements must be present in order for the Government to have a legal right to rescind its final acceptance on the grounds of fraud.[8]

The exact five elements quoted above were again utilized by the Armed Services Board to determine fraud under the Inspection clause in Stewart Avionics, Inc.[9]

Quantum of Proof

It is unclear under current court and board decisions as to whether the preponderance of the evidence, or clear and convincing evidence, is the established quantum of proof necessary to prove the elements of fraud under the standard Inspection clauses as outlined in the decision of Dale Ingram above. The Court of Claims has indicated that clear and convincing evidence is the appropriate measure of proof. In a recent decision concerning a claim under the False Claims Act (31 USC 231),[10] the Court stated that generally in cases of fraud, the "degree of proof necessary to establish fraud demands more than the preponderance of the evidence."[11] Applying this reasoning to the particular claim before the Court, it was further concluded that "The Government has the burden of proving that a contractor's conduct constituted fraud under the False Claims Act by clear and convincing evidence."[12] Although the decision could be interpreted to only apply to fraud under the False Claims Act, a strong indication was given that the court considered the quantum of proof in all cases of civil fraud to be clear and convincing evidence. In a similar manner, the Court of Claims has required that fraud be proven by clear and convincing evidence in cases under the Forfeiture

of Fraudulent Claims Act (28 USC 2514),[13] and when fraud is asserted as an affirmative defense in a suit for a tax refund.[14] Various Federal Courts of Appeal have also utilized a clear and convincing evidence test in considering fraud under the False Claims Act.[15] The various boards of contract appeals, however, appear to utilize the preponderance of the evidence in considering cases of fraud under the Inspection clauses. Conclusions by various boards concerning revocation of acceptance in general have provided that the Government must prove by the preponderance of the evidence that acceptance was not final due to either latent defects, fraud, or gross mistakes amounting to fraud. Although most of these decisions concerned claims for latent defects, and only referred to fraud as part of a general statement about exceptions to finality under the Inspection clause, the decisions do not in any way indicate that the quantum of proof for fraud differs from that required for latent defects. The Armed Services Board in Dale Ingram, Inc.[16] specifically indicated that at least in reference to the reliance element of fraud, the preponderance of the evidence measure of proof is appropriate. In a rare comment on the quantum of proof, the board stated that "we find from the preponderance of the evidence that the Government representative to whom the certificate was furnished did not rely on it as being factually correct."[17] This was the only answer to a clear assertion by the contractor that the Government had

the burden of proving each element of its claim of fraud "not by mere preponderance of the evidence, but by clear and convincing proof."[18]

It is probable that if the Court of Claims in the future has the opportunity to consider an attempt by the Government to revoke acceptance based on a claim of fraud, that the Government will be required to prove such fraud by clear and convincing evidence. With the Armed Services Board apparently only requiring that fraud under the Inspection clause be proven by the preponderance of the evidence, the stage is naturally set for litigation of the quantum of proof issue.

Decisional Application of the Elements of Fraud

Regardless of the quantum of proof that is applied, the Government has had very little success in establishing the presence of all of the elements of fraud as outlined in the principal decision of Dale Ingram, Inc.,[19] previously discussed. As a result of this lack of success and the possible availability of more attractive remedies, there have been very few attempts by the Government to assert fraud under the Inspection clause. Although the decisional guidance is therefore limited, an examination of the principal decision and the small number of additional decisions, does give some insight into the pattern of reasoning that has severely limited the usefulness of fraud as a means to establish post-acceptance liability. In order to understand the rationale

of the decision in Dale Ingram, it is necessary to state the facts of the case in detail.

The contract in Dale Ingram concerned the construction of Capehart Housing for the Army and included a requirement that the plywood to be used in the roof construction should be all mahogany. During performance of the contract, a Government inspector indicated to the contractor that he had doubts as to whether the plywood was all mahogany and the contractor referred the inspector to his subcontractor, the Panama Plywood Company. An in-house quality control inspector employed by Panama Plywood frankly stated that the plywood was not constructed of mahogany. A representative of Panama Plywood management, however, stated that the plywood was all mahogany and asked to have an independent inspection. The independent inspection was conducted by an inspector from the National Hardwood Lumber Association, and the inspector issued a certificate to the effect that the plywood was mahogany. This certificate was given to the Government by a representative of the contractor on May 13, 1960. The contractor and the Government were aware of the contradictory evidence, but the Government continued to believe that the plywood might not be mahogany in spite of the certificate. By this time, two of the housing areas had been completed and accepted by the Government and on September 9, 1960, the final closing and acceptance of the last remaining area was conducted. At the closing, the contractor was required to

execute a Release of Liens and Affidavit of Eligible Builder which was designed to show the contractor was in a position to convey good title to the property free and clear of all liens and encumbrances with the exception of a mortgage. The certificate contained a statement that construction had been in accordance with the plans and specifications. The contractor also signed a certification on behalf of the mortgagor to the effect that construction was in accordance with the plans and specifications, and an attachment to this certification did not list Panama Plywood as an unpaid supplier. Shortly after the one-year warranty period had expired, it was discovered that severe rot and delamination was occurring in a great number of roof structures. Comprehensive testing of the plywood roofing material revealed that non-mahogany plywood had been used contrary to the requirements of the plans and specifications. As a result, the contracting officer immediately took steps to withhold final payment and issued a final decision revoking acceptance on the grounds of latent defects, fraud and gross mistakes amounting to fraud.

Based on these facts, the board concluded that the Government was attempting to establish the five elements of fraud in accordance with the following:

a. The certificate of inspection signed by Mr. Parker of the National Hardwood Lumber Association, which appellant delivered to the area engineer on 13 May 1960. This certificate stated in effect that the plywood was all mahogany, which was contrary to the fact.

> b. The affidavits and certificates executed by appellant's representatives at the final closing of area Army-3 on 9 September 1960. These documents contained misstatements of fact in the following respects: They stated that the housing project had been constructed in accordance with plans and specifications, when in fact the plywood roof sheathing did not conform to the specifications. They stated that appellant did not owe anything to Panama Plywood for the plywood it had furnished for the project when appellant had not paid Panama Plywood anything whatsoever for a large part of the plywood used on the project.
>
> c. Appellant's failure to notify the Government during contract performance that the plywood being used on the job did not conform to specifications when appellant knew this to be a fact.[20]

The initial inquiry concerning these allegations was directed toward a determination of whether as a consequence of these acts, the Government suffered injury. Stated in terms of the Inspection clause, it was an attempt to determine if as a consequence of the fraudulent acts the Government had accepted a structure or product which was defective in material or workmanship, or otherwise not in conformance with the contract. Since the intent of the Inspection clauses is to insure compliance with the contractual requirements, an allegation of fraud under such clause must relate to acceptance of a product or structure which is defective in relation to those requirements. Although the board did conclude that the use of non-mahogany plywood was a cause of injury to the Government, it further concluded that the Government failed to establish the additional elements of fraud.

In reference to the May 13, 1978 certificate from the

National Hardwood Lumber Association, it was held that although the certificate was a factual misrepresentation, the record did not support a finding that the contractor knew the certificate to be in error. Furthermore, since the Government continued to have suspicions about the plywood following receipt of the certificate, it was also concluded that the Government failed in demonstrating its reliance. Similarly, in reference to the certificates issued at the September 9, 1960 closing, the board concluded that although the contractor had a strong belief that the plywood was not all mahogany it was difficult to believe that the contractor intended to mislead the Government, knowing that the Government had the same factual information indicating the use of non-specification plywood. Further in reference to the September 9, 1960 certificates, the board held that regardless of reliance or intent to mislead, the certificates did not relate to acceptance under the Inspection clause. The board reasoned that the certificates were issued in order to obtain the balance of mortgage proceeds without requiring escrow of funds for possible liens. It was concluded therefore that acceptance was not induced by their issuance. Finally, in a short and unreasoned statement, the board concluded that the Government did not prove its contention that the contractor was aware that it was using non-specification plywood and failed to notify the Government. In other words, it was held that the contractor

did not conceal a material fact.

An examination of the Inspection clause supports the board's view in Dale Ingram that misrepresentation or concealment must relate to acceptance and that fraudulent acts must result in the Government's acceptance of products or structures not in compliance with the contract requirements. Care should be taken, however, in applying the board's further conclusion that the Government's suspicion or knowledge of unproven possible contractual non-compliance will preclude successful proof of reliance and intent to mislead. It must be remembered that the assertion of fraud is being considered under the standard Inspection clauses. These clauses place the primary responsibility for contract compliance upon the contractor.[21] Although the Government has the right to inspect for non-compliance, it has no duty to assure that the contractor has fulfilled its responsibility. In light of this relationship, why would it be unreasonable for the Government to rely on a contractor's certification that he had complied with the contract, in spite of suspicion or unproven information to the contrary? Why must it be assumed that there was no intent to mislead just because the contractor is aware that the Government has certain doubts as to contract compliance? The very purpose behind the issuance of certificates may have been to satisfy the Government's doubts and induce acceptance.

There is also some question about the board's conclusion that the Government failed to prove that the contractor was aware of the use of non-specification material and failed to notify the Government. In a discussion of the September 9, 1960 closing certificates, the board stated that "appellant had a strong belief, but no proof, that the plywood did not meet the specification requirements."[22] Is not "a strong belief" evidence of awareness? Did not the failure to reveal this "strong belief" constitute concealment of a material fact? It would appear, therefore, that although the Government's limited knowledge or mere suspicion of a defect can have a direct effect on proof of reliance and intent to mislead, the contractor's knowledge of a defect must be shown to be actual and conclusive.

In Stewart Avionics, Inc.,[23] the Armed Services Board had the opportunity to expand upon the rationale of Dale Ingram and to consider whether the ability of the Government to easily obtain knowledge of a defect would have any effect upon a determination of concealment or intent to mislead. The contractor in Stewart failed to get the contractually required approval for the non-inclusion of a part in a production model which had been included in accepted pre-production models. Following final acceptance of all the production models, the fact that the part had not been included was discovered. In reaching a correct conclusion that fraud was not established, part of the board's rationale

indicated that the intent to mislead and concealment were not proven because the Government could easily have obtained knowledge of the part's non-inclusion through its inspectors who were present in the contractor's plant. Since the contractor knew it was easy for the Government to discover the defect, the board was reluctant to conclude that the failure to include the part was concealed and had been accomplished with the intent to mislead. The Armed Services Board reached a similar conclusion earlier in Hercules Engineering & Manufacturing Co.[24] The contractor in Hercules had attempted to correct dimensional defects by the improper use of shims and washers. The board considered the presence of the Government inspectors and answered the Government's claim of intent to deceive by stating that "The alleged defects were not concealed . . . those not known prior to acceptance could easily have been discovered."[25] It appears, therefore, that even if the Government has no knowledge of the defect, the board will look to the fact that the contractor knows that the defect can easily be discovered by Government inspection. Based on this fact, the board could then conclude that there is no concealment or intent to mislead.

Alternate Government Remedies for Fraud

Part of the reason that very few claims of fraud are asserted under the Inspection clause is the existence of alternative statutory remedies for fraud. These remedies

may exist under the False Claims Act (18 USC 231), the False Statement Act (18 USC 1001), and possibly the Forfeiture of Fraudulent Claims Act (28 USC 2514). If the Government feels that it can carry the heavy burden of proving the intent to deceive, the remedies of the statutory provisions may be more attractive. Under the False Claims Act, for example, the contractor's civil liability may amount to $2,000 for each false claim and double the amount of damages the Government has sustained by reason of the false claim. If the factual situation is appropriate, the contractor may also be subject to forfeiture of all amounts due in association with the false claim under the Forfeiture of Fraudulent Claims Act. Although the quantum of proof required under these statutory provisions can be greater than that required under the Inspection clause,[26] this may be more than offset by the fact that it is not necessary to prove that the items received were defective. All the Government must do is prove fraud in the inducement.[27]

Gross Mistakes Amounting to Fraud

The Court of Claims in Bar-Ray Products Inc. v. United States[28] reached the conclusion that the reason gross mistakes amounting to fraud was added to fraud as an exception to finality under the Inspection clauses was to obviate the need for proof of intent to deceive. The elements of a gross mistake amounting to fraud were therefore considered to be the same as the elements of fraud, with the exception

of the intent to deceive. The Armed Services Board in the landmark decision of Catalytic Engineering & Manufacturing Corp.[29] focused upon the conclusion of the Court of Claims in Bar-Ray and rendered a comprehensive analysis of the meaning of gross mistake amounting to fraud.

The Catalytic Decision

The board in Catalytic held that in order for the Government to carry its burden of proof in establishing a gross mistake amounting to fraud, that the Government must demonstrate by the preponderance of the evidence[30] that acceptance of a defective contract item was induced by (1) a major mistake so serious as not to be reasonably expected of a responsible contractor, and (2) an unintentional misrepresentation of a material fact. The board reasoned that "mistake" means an unintentional error and that "fraud" refers to a misrepresentation of a material fact by mistake. "Gross" was determined to mean a serious mistake not expected of a responsible contractor.

The application of the definition stated above can best be understood by examining the particular facts upon which the decision in Catalytic was based. The contractor in Catalytic submitted an unsolicited proposal for production of dehydrator cartridges for use in removal of moisture from certain aircraft parts in flight. Accompanying the proposal were drawings of the cartridges which designated that the end pieces would be made of polyvinal chloride, and which

referred to the cartridges as Catalytic's part number 3120. Following limited Government testing, the contractor was notified that the proposal was acceptable and that he was to be placed on the list of those eligible to bid. Shortly after this notification, the contractor, without informing the Government, made certain changes in the drawings of the cartridge known as part number 3120 and substituted polystyrene for polyvinal chloride as the material from which end pieces were to be constructed. Several months later, the contractor submitted a bid in response to an invitation and indicated that the cartridge he would supply was Catalytic part number 3120. The contractor did not inform the Government of the changes made in the cartridge since his original proposal. The contractor was awarded the contract, and several months later he was also awarded a follow-on contract. During inspection of production under these contracts, the contractor gave the inspector the new revised drawings but never explained that they differed from those originally supplied with the unsolicited proposal. Following acceptance and completion of both contracts, the end pieces made of polystyrene began to deteriorate, rendering the cartridges totally useless.

The board initially concluded that the contractor's use of a different material without knowing if it would work, was a gross mistake. It was not, however, a gross mistake amounting to fraud since the mistake standing alone did not induce acceptance and in no way involved a mis-

representation to the buyer. The board took the opportunity to stress that because an intent to deceive is not necessary, the fact that the contractor thought he was improving the product, or was acting in good faith, was irrelevant.

The board further concluded that the contractor did make a gross mistake amounting to fraud when it failed to advise the contracting officer that it made changes in the drawings and would use different material in the end pieces. It was a gross mistake because it was not one reasonably to be expected of a responsible supplier whose only customer for the item was the Government and who had initially supplied a different drawing. Such a mistake was out of all measure and beyond allowance. The gross mistake amounted to fraud because there was a misrepresentation of a material fact which induced acceptance of items that did not meet the contract requirements. In the unsolicited proposal and the bids for the two contracts, the contractor represented that its part 3120 would have polyvinal chloride end pieces. This was a misrepresentation because the part when tendered for acceptance did not have polyvinal chloride end pieces. Prior to acceptance the contractor should have told the contracting officer of this change, and the failure to do so occasioned the acceptance of non-conforming goods.

In a similar manner, it was also concluded that there was a gross mistake in failing to advise the inspector that the new drawings he was furnished differed from the original drawings. The mistake was gross in that it was out of all

measure, and beyond allowance, and one not to be expected of a responsible contractor. The gross mistake amounted to fraud because it misrepresented a material fact. The new drawings were provided with the indication that they were the same as those drawings originally approved, when in fact they differed in the type of material to be used. The use of such drawings induced acceptance of a product that did not conform to the contract. It was a gross mistake amounting to fraud even though there may have been no actual bad faith and even though the misrepresentation may have been made by mistake and without the intent to deceive.

Bad Faith

It can be seen from the above analysis that not only did the board in Catalytic conclude that an intent to deceive was not an element of a gross mistake amounting to fraud, but the board also concluded that a gross mistake could be equated to fraud even if innocently made and in good faith. The latter conclusion has been controversial and difficult to apply. In a well-reasoned dissent to the majority opinion in Catalytic, the Vice-Chairman of the Armed Services Board stated that "the long line of cases where gross mistake has been equated to fraud hold that fraud involves conscious intentional wrongdoing and that gross mistake does not equate to fraud except under circumstances where the action is so palpably wrong that it could not have been taken by a person acting in good

faith."[31] It is the conclusion of the dissent, therefore, that although it is not necessary to prove an intent to deceive by direct evidence, it is necessary to demonstrate that an intent to deceive is implied by evidence of actions so palpably wrong that they are equivalent to bad faith.

The majority opinion adds confusion to the issue by referring to "good faith" and "honesty" in its analysis of the facts. After an extensive discussion of why a finding of bad faith or actual intent to deceive is not necessary, the board later in the opinion stated that "the mistake is one that cannot be reconciled with good faith and one which a responsible contractor acting honestly would not reasonably be supposed to make."[32] In a similar manner subsequent decisions of the Armed Services Board indicate that although the board states that bad faith is not necessary, in practice it is required. In Kit Pack Co.,[33] for example, the board agreed that a particular mistake was a gross mistake but concluded that the Government failed to show a misrepresentation or lack of good faith. Similarly, in Onus Co.[34] it was held that "we are unable to conclude that the mistake made by appellant was either gross or one which cannot be reconciled with good faith."[35] The board found in Ordnance Parts & Engineering Co.[36] that the record supported the conclusion that the appellant "acted in good faith."[37] The Government also failed to prove a gross mistake amounting to fraud in Stewart Avionics, Inc.[38] when there was no

evidence presented to show that the contractor knew his actions would adversely affect the product. Such proof would not have been necessary if the contractor's good faith or bad faith was not relevant.

In spite of the language in Catalytic, the established rule appears to be that a gross mistake amounting to fraud cannot be proven without a showing of bad faith.

The Gross Mistake Amounting to Fraud Must Affect Conformity of the Item to the Specifications or Performance Requirements

It has been held in accordance with the decision in Catalytic that in order to establish a gross mistake amounting to fraud it must be shown that the contractor's actions induced acceptance of supplies or structures that do not conform to the contract requirements.[39] This is consistent with the purpose of the standard Inspection clauses which provide for rejection or setting aside of items that do not meet contract requirements. In Southern Pipe & Supply Co.,[40] however, the NASA Board concluded that the non-conformance to contract requirements only refers to specification or performance requirements. The board reasoned that in accordance with Catalytic, the non-conformance must render the item unsuitable for its intended use and only a failure to comply with performance requirements or specifications would cause such unsuitability. Since the items in question

only failed to meet the contract's requirements because they were in violation of the Buy American Act, such a "collateral matter" did not render the product unsuitable for use.

The language from the decision in Catalytic that the NASA board used to support its conclusion that the item must be unsuitable for its intended use was taken out of context, however, and misapplied. The specific language as quoted by the NASA board states that "The misrepresented fact was a material fact because polystyrene end pieces did not comply with the contract requirements and, more importantly, rendered the part unsuitable for its intended use by the Government."[41] The reference to unsuitability here was merely to show that the misrepresented fact was material. It was material because it induced the Government to believe that the product it was accepting met the contract requirements, when in fact it was not suitable for its intended use. It was not in any manner a comment on contract non-compliance. Although the board in Catalytic did raise the question of whether the "contract language limits the gross mistakes to gross mistakes in the acceptance or, in addition, requires that there be some gross mistake in the item accepted, i.e., a failure to comply with contract requirements that substantially impair its value to the buyer,"[42] the board specifically refused to answer that question.

The Armed Services Board in later decisions, however, did give support to the conclusion in Southern that the

gross mistake amounting to fraud exception to finality only relates to acceptance of items that do not conform to the specifications or performance requirements. In Asiatic Petroleum Corp.,[43] it was held that the failure of the contractor to obtain fuel from a source required in the contract was a breach of contract only and not a basis for revoking acceptance under the Inspection clause. The decision could be interpreted to stand for the proposition that the right to set aside acceptance under the Inspection clause only refers to products or structures that are defective as to physical requirements, and not to those products or structures that fail to meet minor collateral contract requirements. Similarly, in Ordnance Parts & Engineering Co.,[44] the board denied a claim of gross mistake amounting to fraud based on an improper certification of compliance with source-qualification requirements and stated that "we must also not ignore the fact that the contract items fully complied with all the technical requirements of the contract."[45]

The conclusions reached in Asiatic and Ordnance can be accepted since the deficiencies involved did not materially alter the performance of the contracts, or violate basic procurement policy. In Southern, however, the deficiency violated a basic procurement policy as embodied in the Buy American Act. It is difficult to conclude that acceptance should not be revoked for such a violation.

Mistake So Serious As Not To Be Reasonably Expected of a Responsible Contractor

A gross mistake was defined in Catalytic as "a mistake so serious or uncalled for as not to be reasonably expected, or justifiable, in the case of a responsible contractor for the items concerned."[46] The application of this definition has required a determination of whether the contractor's action was reasonable in consideration of the surrounding circumstances. In the Catalytic decision itself, the very fact that the contract in question was a Government contract was considered one of the surrounding circumstances that reflected on whether the contractor's action in changing material without approval was reasonably to be expected. Since Government approval of changes in material was usually practiced in Government contracting, the contractor's change of material without that approval was considered to be unreasonable.

On several occasions a claim of gross mistake amounting to fraud has been asserted as the result of a contractor's action or inaction based on his interpretation of a specification, test result, or other contract requirement. If the contractor is mistaken in that interpretation, and the contract item is defective, the mistake can amount to a gross mistake if the interpretation was unreasonable under the circumstances. In a similar manner, the contractor's failure to tell the Government of evidence contrary

to his interpretation can also be considered a gross mistake if unreasonable under the circumstances. In Hydro Fitting Manufacturing Corp.,[47] for example, the Government asserted a gross mistake amounting to fraud when the contractor mistakenly interpreted certain test results as indicating contract compliance and failed to inform the Government of contrary results. Although the test indicated a certain failure rate, the contractor concluded that the total results still indicated an acceptable product. The contractor made certain X-ray films available to the Government but made no affirmative disclosure of test reports which revealed the limited failures. Following inspection by an incompetent Government inspector, the defective items were accepted. The Armed Services Board concluded that the contractor's interpretation of the test was not a gross mistake since it reflected an honest judgment that was reasonable.

The board also concluded that the failure to disclose the testing failures was not unreasonable, but on very unusual grounds. It was held that the contractor had every right to assume that the Government would send a competent inspector to perform acceptance inspection and that the inspector would be knowledgeable with respect to the production requirements. Since the contractor had given the inspector the X-rays, and the inspector did not ask for the written interpretation, the contractor was entitled to assume that the Government was equipped to evaluate the films and reach its own conclusions. Based on these facts, the

board stated "We are not persuaded that the appellant acted so unreasonably in this matter as to warrant a conclusion that it made a gross mistake amounting to fraud."[48] This reasoning is unusual, of course, because it is generally held that although the Government has a right to inspect, it has no duty to inspect and the failure to exercise that right does not affect the legal liability of the contractor. There is some additional support, however, for examining the conduct or competence of a Government inspector in determining whether a contractor's actions were reasonable. The General Services Board found in A. Brown & Co.[49] that the contractor's use of improper fill dirt was not unreasonable and did not constitute a gross mistake amounting to fraud since the Government inspector approved the borrow pit, conducted compaction tests, and allowed the contractor to continue without complaint. In a similar manner, the Armed Services Board in A.C.E.S., Inc.[50] looked to the fact that the Government's inspector continued to improperly approve unacceptable items as an important factor in finding that the contractor's action was not a gross mistake.

The conclusions of Hydro are radically altered, however, when the contract contains quality-assurance requirements that place the responsibility of inspection and testing on the contractor. This is especially true when the contractor is required to issue a certification that his product is in compliance with the contract requirements. In Jo-Bar Manufacturing Co.,[51] the Government asserted that the contractor's

mistaken interpretation that the specifications did not require a heat treatment process, and the contractor's misleading statements to the inspector constituted a gross mistake amounting to fraud. The contractor argued that in accordance with Hydro, his actions were reasonable. Although the facts were very similar, the board concluded that "the instant case is factually distinguishable from Hydro Fitting in that here appellant was required to provide certification that his product met the contract requirements. Here the respondent was not required to conduct any final inspection . . . but could rely solely on appellant's certifications. . . ."[52] In concluding that the contractor's action constituted a gross mistake amounting to fraud, it was apparent that the board felt that the Government's rightful reliance on the certificate of compliance raised the standard of reasonableness. The General Services Board appears to have gone even farther in holding that certificates of product compliance affect the standard of reasonableness. In Boston Pneumatics Inc.,[53] the General Services Board considered a provision that if the contract-specified test had previously been performed on the tool being offered at the time of bid invitation, then the manufacturer was permitted to furnish certified proof that the tools being offered were identical to those previously tested and approved, and testing in accordance with the specifications would not be necessary. During performance, the Government inspector made only

superficial tests because the contractor had furnished the certification. The board stated that the certification offered the Government greater protection than would be the case if the Government relied solely on the specifications in seeking any redress from the contractor. It was held without analysis or reasoning that "It is evident from the circumstances of this case that the acceptance of the [defective] units were induced by such a gross mistake as to amount to fraud."[54] The implication is made, although not substantiated, that the incorrect furnishing of a certification of contract compliance will be considered unreasonable and will automatically constitute a gross mistake amounting to fraud.

Misrepresentation of a Material Fact

The decision in Catalytic made it clear that one of the elements of fraud inherent in the concept of a gross mistake amounting to fraud is the existence of a false representation of a material fact. In commenting on this requirement, the board stated that "A false representation or misrepresentation could be by words or conduct or by false or misleading allegations or by concealment, i.e., failure to disclose facts that should have been disclosed in the circumstances."[55]

The misrepresentation, however, must be of a fact as opposed to a matter of law or opinion. In Hydro Fitting Manufacturing Corp.,[56] previously discussed, the distinction

between the misrepresentation of a material fact and the expression of an opinion was considered one of the key elements in concluding that a gross mistake amounting to fraud did not exist. In response to a question from an unknowledgeable inspector as to what certain X-rays of the product indicated, the contractor in Hydro responded that the results were considered to be acceptable results. The board concluded that this was not a misrepresentation of a material fact but only an opinion which reflected an honest judgment of the contract requirements.

CHAPTER TWO

FOOTNOTES

1. Standard Form 23A, Clause 10(f); Standard Form 32, Clause 5(d).

2. Dale Ingram, Inc., ASBCA 12152, 74-1 BCA ¶ 10,436 (1974).

3. ASBCA 4979, 59-2 BCA 2426 (1959).

4. Id. at 11,418.

5. 167 Ct. Cl. 839, 340 F.2d 343 (1964).

6. Id. at 851.

7. Supra n. 2.

8. Id. at 49,331.

9. ASBCA 15512, 15893, 75-1 BCA ¶ 11253 (1975).

10. Fred Hageny v. United States, Ct. Cl. No. 12-73 (Jan. 25, 1978).

11. Id. at 15, 16.

12. Id. at 16.

13. Kamen Soap Products Co. v. United States, 129 Ct. Cl. 619, 24 F. Supp. 608 (1954); Acme Process Equipment Co. v. United States, 171 Ct. Cl. 324, 347 F.2d 509 (1965).

14. DeWitt v. United States, 204 Ct. Cl. 274 (1974).

15. United States v. Ueber, 229 F.2d 310 (6th Cir. 1962); United States v. Aerodex, 469 F.2d 1003 (5th Cir. 1972); United States v. Bass, 472 F.2d 207 (8th Cir. 1973).

16. Supra n. 2.

17. Id. at 49,331.

18. Id. at 49,304.

19. Supra n. 2.

20. Id. at 49,331.

21. Standard Form 23A, Clause 10(a); Standard Form 32, Clause 5(d).

22. Supra n. 2, at 49,332.

23. Supra n. 9.

24. Supra n. 3.

25. Id. at 11,418.

26. See previous discussion of quantum of proof.

27. United States v. Steiner Plastics Co., 231 F.2d 149 (2d Cir. 1956); See Hill, "The Finality of Acceptance Under Government Supply Contracts," 3 Pub. Cont. L.J. 97 (1970).

28. Supra n. 5.

29. ASBCA 15257, 72-1 BCA ¶ 9342, aff'd on rehearing, ASBCA 15257, 72-2 BCA ¶ 9518 (1972).

30. There does not appear to be an issue of quantum of proof as exists in the establishment of fraud.

31. Catalytic Engineering & Manufacturing Co., supra n. 29 at 43,375.

32. Id. at 43,369.

33. ASBCA 16766, 73-2 BCA ¶ 10,111 (1973).

34. ASBCA 16706, 72-2 BCA ¶ 9722 (1972).

35. Id. at 45,410.

36. ASBCA 18841, 74-2 BCA ¶ 10,717 (1974).

37. Id. at 50,976.

38. Supra n. 9

39. H. Bendzulla Contracting, Inc., ASBCA 18588, 74-1 BCA ¶ 10,690 (1974).

40. NASA BCA 570-7, 72-2 BCA ¶ 9512 (1972).

41. Id. at 44,326.

42. Catalytic Engineering & Manufacturing Co., supra n. 29, at 43,362.

43. ASBCA 17765, 74-2 BCA ¶ 10833 (1974).

44. Supra n. 36.

45. Id. at 50,976.

46. Catalytic Engineering & Manufacturing Co., supra n. 29 at 43,365.

47. ASBCA 16394, 73-2 BCA ¶ 10,081 (1973).

48. Id. at 47,368.

49. GSBCA 3575, 73-2 BCA ¶ 10219 (1973).

50. ASBCA 19150, 75-2 BCA ¶ 11525 (1975).

51. ASBCA 17774, 73-2 BCA ¶ 10311 (1973).

52. Id. at 48,685.

53. GSBCA 3122, 72-2 BCA ¶ 9682 (1972).

54. Id. at 45,212.

55. Catalytic Engineering & Manufacturing Co., supra n. 29, at 43,366.

56. Supra n. 47.

CHAPTER THREE

FREQUENTLY UTILIZED GOVERNMENT REMEDIES WHEN DEFECTS SURVIVE ACCEPTANCE

If acceptance is not final and conclusive due to latent defects, fraud, or gross mistakes amounting to fraud, the Government may revoke acceptance and utilize the remedies that would have been available prior to acceptance.[1] The remedies that are most often used are those provided in the standard Inspection clauses, or an action in the nature of restitution. Remedies included in warranty provisions are also frequently used if such warranty provisions are applicable.

In the following section, an initial inquiry will be made into whether the right to revoke acceptance for latent defects, fraud, or gross mistakes amounting to fraud is limited by a reasonable time standard or the doctrine of substantial performance. Subsequent sections will then discuss the specific remedies of the standard Inspection clauses, restitution, and the possible application of stated warranties.

Limitations on the Right To Revoke Acceptance

It is often stated that the right to revoke acceptance

for latent defects, fraud, or gross mistakes amounting to fraud can be exercised at any time the basis for such revocation is discovered. In other words, the contractor is liable for latent defects, or for defects which were accepted due to fraud or gross mistakes amounting to fraud, for an unlimited period of time following acceptance. In Cottman Mechanical Contractors,[2] for example, the Armed Services Board held that the standard Inspection clause protects against latent defects without regard to time.[3] In other decisions, however, the same board has given an indication that the Government's right to revoke acceptance may not be as unlimited in time as the decision in Cottman would indicate. In Marmon-Herrington Co.,[4] it was held that subparagraph 5(d) of Standard Form 32 concerning latent defects negates the finality of acceptance "thus extending the right to such defects for a reasonable time following acceptance."[5] Later, in Catalytic Engineering & Manufacturing Corp.,[6] a reasonable time was apparently held to be that period following acceptance during which the Government should have discovered the defect in material or workmanship. In concluding that acceptance could be revoked for a gross mistake amounting to fraud, the Armed Services Board stated that "The Board finds further that the Government revoked the acceptance of such cartridges within a reasonable time after it discovered, or should have discovered, the basis for the revocation."[7] The board in Catalytic quoted

extensively from UCC, Section 2-608(2), which provides that "Revocation of acceptance must occur within a reasonable time after the buyer discovers or should have discovered the ground for it. . .".[8] The holdings of Catalytic and Marmon-Herrington are clear indications that at least in the case of latent defects or gross mistakes amounting to fraud that the right to revoke acceptance for an unlimited time may be restricted by a standard of reasonableness. Since fraud involves an intent to deceive and indicates a degree of criminal culpability, there have been no serious attempts to apply a reasonable time standard to revocation of acceptance due to fraud.

The right to revoke acceptance may also be limited by the nature of the defect involved. If the defect is minor, and does not substantially impair the value of the supplies or construction, the doctrine of substantial performance could possibly restrict the Government's right to revoke acceptance, reject the goods, and terminate for default. It is clear in the pre-acceptance situation that the Government cannot always reject supplies and default terminate a contractor for minor defects in materials and workmanship even if the time for performance has passed. In Radiation Technology Inc. v. United States,[9] for example, the Court of Claims held that the contractor must be allowed a reasonable time beyond the contract schedule to correct non-conforming supplies if it can be shown that (1) the contractor had reasonable grounds to believe that his

delivery would conform to contract requirements, and (2) the defect was minor and of a nature and extent that could easily be corrected.[10] In reaching this conclusion, the court appears to have been relying on UCC Section 2-608(1), which limits revocation of acceptance to those cases where the "non-conformity substantially impairs"[11] the value of the work. A similar line of reasoning has consistently been applied to substantial performance in construction contracts.[12] Although there have been no decisions specifically applying the doctrine of substantial performance to an attempt to revoke acceptance for latent defects, fraud or gross mistakes amounting to fraud, it would appear that at least in respect to minor latent defects that it could easily be applied. There is no apparent reason to treat a minor latent defect which is discovered after acceptance any different from a minor patent defect that is discovered prior to acceptance. The doctrine of substantial performance could also be applied to defects that were accepted due to a gross mistake amounting to fraud if the view was taken that such gross mistakes did not involve bad faith or indicate culpability. In the case of fraud, however, there would be no valid reason to reward an intentional act of deceit with an opportunity to avoid rejection or termination for default.

The Standard Inspection Clause Remedies

If acceptance can be revoked due to latent defects, fraud, or gross mistakes amounting to fraud, the Government

may utilize the specific remedies as outlined in the standard Inspection clauses of fixed-price supply and construction contracts. These remedies are to be utilized in accordance with a two-step procedure. In the following discussion, this two-step procedure and the specific remedies will be analyzed.

The Two-Step Procedure

The procedural scheme of the standard Inspection clauses provides that as a first step the Government may reject the defective work and require correction or replacement by the contractor.[13] If the contractor fails to correct or replace, the second step provides that the Government may by contract or through its own resources obtain correction or replacement at the contractor's expense, or the Government may terminate for default under the appropriate Default clauses.[14] The standard Inspection clauses also provide that the Government may retain the work or product and receive an appropriate reduction in price.[15] In construction contracts, a reduction in price may be asserted as an alternative to a demand for correction or replacement. In fixed-price supply contracts, a reduction in price can only be obtained if the contractor has failed to correct or replace as required.

The two-step procedure described above must be strictly followed or certain remedial rights may be lost. In Techni Data Laboratories,[16] for example, the Government rejected certain defective work and corrected the work with Government personnel. In denying the Government's claim for the total

cost of correction, the Armed Services Board held that the Government was not entitled to charge the contractor with its own cost of correcting deficiencies absent proof that the contractor would have refused to make corrections, or would have been unable to do so within a reasonable time.[17] Similarly in Abbott Power Corp.,[18] the Veterans Administration Board denied the Government's claim for correction cost when the Government failed to demand that the contractor correct the defects before engaging another firm to make corrections. The board reasoned that only after a contractor fails to correct deficiencies can the Government take further action under the Inspection clause.[19]

Rejection and Contractor Replacement or Correction

The right of rejection is the initial remedy that is available to the Government under the standard Inspection clauses when acceptance is revoked due to latent defects, fraud, or gross mistakes amounting to fraud.[20] In fact, a notice of rejection is normally the first means by which the Government actually revokes acceptance and informs the contractor of the nature of the defect. The notice must fairly and correctly state the reasons for rejection and must be given within a reasonable time following discovery of the defects.[21] Delay in giving notice could be deemed to be a re-acceptance of the defective products or structure, to which finality and conclusiveness would again attach.[22]

The Government may also demand in the notice of rejection that the contractor replace or correct the deficiencies. Even if such a demand is not specifically made, however, once the notice of rejection is given, the risk of loss for the deficient supplies or construction shifts back to the contractor, and the contractor is under an obligation to correct or replace within a reasonable time.[23]

Government Correction or Replacement

If the contractor fails to correct or replace defective work, the standard Inspection clauses also provide that the Government may correct or replace it, or contract with another party for correction or replacement, at the contractor's expense.[24] The amounts and nature of such expenses have been a source of continuing controversy. The Armed Services Board in F.L. Jacobs[25] stated that costs chargeable to the contractor when Government self-help is necessary may include all "direct costs reasonably and necessarily incurred"[26] in replacing or correcting the defective work. Such costs were held to include not only the cost of correcting a specific latent defect but also the cost associated with the disassembly and assembly of the equipment in which the defect was located.[27] In a similar manner, the Interior Board held in General Electric Co.[28] that the reasonable and necessary costs incurred in repair of a defective transformer included the cost of a new part, the cost of removing the defective part and reinstalling a new one, and the cost

of a substitute part while the new part was on order. The reasonable costs of replacement or correction, however, may be reduced by an amount that reflects the period of time during which the item has operated successfully. The board further held in General Electric Co., for instance, that since the defective transformer part performed satisfactorily for four years and completed 15,000 of the expected 50,000 operations, that the Government's recovery for the new part should be reduced by one-third.

When the Government actually replaces or corrects defective work under the standard Inspection clauses, it does not have to do so with supplies or materials that are similar to those originally required by the contract.[29] The amount the Government can recover, however, will be limited to the costs of the items originally specified in the contract. If the Government replaces or corrects defective work therefore in a manner which exceeds the original contract requirements in quality or quantity, there can be no recovery for the difference in costs.

It has also been held that reasonable cost of correction and replacement includes the costs of any required Government inspection that may be necessary to insure that the repaired or replaced work meets the contract specifications. As stated by the Armed Services Board in Harrington & Richardson Inc., the "Government may recover such extra cost of inspection as were the natural and probable consequences of the contractor's failure to comply with the contract requirements."[30]

The standard Inspection clauses also clearly warn the contractor that the Government reserves the right to charge the contractor when reinspection or retest is necessitated by a prior rejection.[31] The Government must specifically demonstrate, however, that the extra inspections as performed were necessary.[32]

The reasonable costs of correction and replacement under the standard Inspection clauses may also include special costs or consequential damages. Unlike general damages which are inferred from the fact of the contractor's breach, consequential damages must be proven to be a foreseeable, direct and proximate result of such breach. The Court of Claims appears to have approved of the recovery of such damages in Kaminer Construction Co. v. United States.[33] Although the decision did not speak in terms of foreseeability, proximate cause, or consequential damages, the court allowed the Government to recover the cost of replacing a number of buildings that were destroyed when a tower containing a latent defect collapsed. These costs were not directly related to repair of the defective work, but they were a foreseeable consequence and proximately caused by the latent defect. Two Federal Court decisions have awarded similar costs and in doing so have directly referred to these costs as consequential damages. In United States v. Aerodex,[34] the Government asserted a claim for $161,000 in consequential damages for breach of warranty. The consequential damages represented the cost the Government incurred in

removing and replacing aircraft engine bearing which had been accepted due to fraud. Although the warranty provision did not allow for consequential damages, the warranty provision specifically provided that its remedies would not be exclusive if the breach involved latent defects, fraud, or gross mistakes amounting to fraud. The Fifth Circuit Court of Appeals concluded that the Government was not bound to the remedies under warranty provisions and the court apparently awarded the consequential damages under the standard Inspection clause provisions which allow recovery of the costs of correction and replacement following revocation of acceptance for fraud. The Ninth Circuit Court of Appeals appears to have reached the same conclusion in United States v. Franklin Steel Products.[35] The contract involved in Franklin was also for aircraft engine bearings and contained the same warranty clause as the contract in Aerodex. The court decided that the warranty had been breached and that the Government was not restricted to the Warranty clause remedies. Instead of using fraud as the exception to the exclusive remedy provision of the Warranty clause, the court found that there were two latent defects and awarded consequential damages in excess of $147,000 for the recall and replacement of master rod bearings. Such expense was seen as foreseeable due to the critical nature of the parts.

It is to be noted that in response to such cases, the

Armed Services Procurement Regulation now states in ASPR 1-330 that it is the Government's policy to limit the contractor's liability for damage to Government property resulting from defective supplies delivered under Government contract. The exceptions and limitations to this policy, however, appear in practice to destroy its effectiveness and usefulness. For example, ASPR 1-330 initially provides in contracts where the unit price is $100,000 or less that the limitation on liability does not apply to the end item itself. In addition, it also does not apply when the contractor's liability can be preserved without increased costs, or the contractor's liability is expressly provided for by another clause in the contract. The limitation on liability also does not apply if the contractor carries insurance or there is evidence of willful misconduct or lack of good faith. Although the limitation on liability is extended to the end item itself if the unit price exceeds $100,000, the provision expressly states that it does not limit the contractor's other obligations to correct defects under other clauses, and if repair or replacement is not feasible or desired by the Government, the contractor must pay an amount that it would have cost to repair the end item. It would appear that in spite of ASPR 1-330 the award of consequential damages is a real possibility when replacement and correction costs are asserted under the Inspection clauses.

Termination for Default

If the contractor fails to correct or replace defective work, the standard Inspection clauses also provide that the Government may terminate for default under the standard Default clause. It should be noted, however, that if the Government has previously attempted correction or replacement, it is precluded from thereafter utilizing the default remedy.[36] If Government correction or replacement has not been attempted, the standard Default clause for construction contracts provides that "The Government may take over the work and prosecute the same to completion, by contract or otherwise, and may take possession of and utilize in completing the work such materials, appliances, and plant as may be on the site of the work and necessary therefore."[37] In addition, agreed liquidated damages may be assessed for delay until the construction is completed.[38] The standard Default clause for supply contracts provides that "The Government may . . . procure supplies or services similar to those so terminated, and the contractor shall be liable to the Government for any excess cost for such similar supplies or services."[39] Here, unlike correction or replacement directly under the standard Inspection clause as previously discussed, the failure of the Government to reprocure supplies that are similar to the original contract goods can destroy the Government's right to hold the contractor liable for excess cost.[40] Though the requirement

that the goods be similar is a rather strict standard, the reprocured goods need not be identical.[41] The Government must also reprocure in a timely and reasonable manner in order to mitigate damages.[42] It is unclear, however, whether the failure to reprocure in a timely and reasonable manner will totally bar recovery for excess cost.[43]

If for some reason reprocurement is not feasible, the standard Default clauses also provide that the remedies of the Default clauses are in addition to any other rights and remedies provided by law. Thus, if reprocurement cannot be accomplished, the Government could use any additional common-law damage remedies not stated in the Inspection clauses,[44] or the Government could possibly apply the provisions of the Uniform Commercial Code.

Reduction in Price

The standard Inspection clauses also provide that the Government may retain the defective work and receive an equitable reduction in price. If the Government desires to pursue such an option, it will usually only do so if the non-conformance is minor and retention is determined to be in the public interest.[45] The Armed Services Procurement Regulation defines minor as having no effect on performance, durability, reliability, interchangeability, effective use or operation, weight, appearance, health, or safety.[46] Due to these restrictive conditions for use, retention of defective goods and a reduction in price appears to be very

rarely used. Even if a defect meets the criteria, it is generally held that the Government cannot be compelled to utilize the option of retention and reduction in price.[47]

Restitution

When acceptance is revoked due to latent defects, fraud, or gross mistakes amounting to fraud, the Government may utilize a restitutionary remedy in addition to the remedies contained in the standard Inspection clauses. Under the theory of restitution, a seller is required to return any monies paid for defective work, and a buyer is required to return the supplies or services or allow credit for the value of work that cannot be returned. The Court of Claims in Bar-Ray Products Inc. v. United States[48] applied such a restitutionary remedy and concluded that since the acceptance of some defective units were induced by a gross mistake amounting to fraud, that the contract could be reopened and that the Government was well within its rights to demand repayment of the purchase price. Similarly, the Armed Services Board in Catalytic Engineering & Manufacturing Corp. stated that since "The Government revoked acceptance . . . it is entitled to the return of the amount paid."[49] Under normal conditions, the Government must also return the supplies or give credit if return is not possible.[50] It does not have to do so, however, if the work is shown to be "utterly worthless."[51]

The theory of restitution used in Government contracting,

however, does not appear to be based on the traditional common-law approach but instead appears to follow the more liberal view of restitution as expressed by Corbin and the Uniform Commercial Code. Under the traditional common-law view of restitution, the delivery of defective supplies is a breach of contract which justifies the buyer in rescinding the contract. Based on that rescission, each party is then required to return what he got under the contract.[52] Since rescission is required, the buyer must be very careful not to elect some other additional remedy which is inconsistent with the act of rescission. Corbin has stated a more liberal view, however, and has concluded that restitution does not require rescission and is only an optional way of measuring general damages for breach of contract.[53] The Uniform Commercial Code has adopted this view in UCC, Section 2-711, which provides that in addition to recovering so much of the purchase price paid, the buyer may "cover" or have damages under UCC, Section 2-712 or 2-713. The Code intentionally omitted any reference to rescission in order to reinforce the idea that restitution is only one element of damage to be awarded along with other appropriate elements and is not dependent on any theory of rescinding the contract.[54]

In the Government contracts area, the liberal view of Corbin and the Uniform Commercial Code has specifically been applied. In National Bag Corp.,[55] for example, the General Services Board applied the theory of restitution as embodied in UCC, Section 2-711, when the Government asserted

a demand for correction or replacement, or reimbursement of the price paid. The board held that although there was no contract clause expressly providing for recovery of the price paid, that under general principles of law as contained in UCC, Section 2-711, the Government could "recover the purchase price paid, and recover certain other damages."[56] It is clear from the decision that the assertion of a restitutionary remedy did not prevent the use of other remedies under the contract which is in direct conflict with the traditional view of restitution based upon rescission.

The Use of Warranty Provisions

Fixed-price supply and construction contracts may include specific warranties that cover defects in material, equipment, or workmanship for a stated period of time following acceptance. Standard warranties usually provide for the remedies of correction and replacement or an equitable reduction in price if the warranty is breached.[57] Although such warranties are generally included to provide protection for patent defects that ordinarily would not be covered beyond acceptance, these warranties generally will also cover latent defects, or defects connected with fraud or gross mistakes amounting to fraud, discovered during the warranty period.

In cases where latent defects, fraud, or gross mistakes amounting to fraud are covered by a warranty, the Government has the option of proceeding with its remedies under the

Inspection clause or under a Warranty clause, or a combination of both.[58] As indicated by the Armed Services Board in Keco Industries Inc.,[59] the rights of the Government under Inspection and Warranty clauses "should be construed as cumulative and complimentary."[60]

There may be many valid reasons for the Government to choose one clause over the other, or to combine them. For example, if a latent defect is discovered during a warranty period, the Government may choose to utilize the remedies of a warranty provision in order to avoid the necessity of proving that the defect was not discoverable by reasonable inspection which is required to be proven under the Inspection clause. On the other hand, the Government may wish to exercise certain remedies that are available under an Inspection clause that may not be available under a Warranty clause. In Philos Construction Co.,[61] for instance, the contract in question contained a warranty provision that allowed the Government to seek contractor correction or replacement but was silent as to the remedies available to the Government if the contractor refused. After the contractor refused to correct the latent defect under the warranty provision, the Government charged the contractor for the cost of correction under the Inspection clause. In approving this procedure, the Department of Transportation Board clearly indicated that in the presence of latent defects, fraud, or gross mistakes amounting to fraud, the

Government could utilize the best remedial provisions of either clause.[62]

It can be seen that although the remedial provisions of a Warranty clause do not usually add new or different remedies, the use of such remedies alone, or in combination with the Inspection clause, may have tactical or procedural advantages.

CHAPTER THREE

FOOTNOTES

1. Jo-Bar Manufacturing Corp., ASBCA 1774, 7302 BCA ¶ 10,311; Bar-Ray Products, Inc., 167 Ct. Cl. 839, 340 F.2d 343 (1964); Bar-Ray Products Inc., ASBCA 4834, 59-1 BCA ¶ 2181 (1959); Philos Construction Co., DOTCAB 67-33, 68-2 BCA ¶ 7110 (1968); Cross Aero Corp., ASBCA 14801, 71-2 BCA ¶ 9075 (1971); Trio Chemical Works, GSBCA 2572, 70-1 BCA ¶ 8156 (1970).

2. ASBCA 11387, 67-2 BCA ¶ 6,566 (1967).

3. Id.

4. ASBCA 10,889, 67-2 BCA ¶ 6523 (1967).

5. Id. at 30,316.

6. ASBCA 15257, 72-1 BCA ¶ 9342 (1972).

7. Id. at 43,370.

8. UCC, Sec. 2-608(2).

9. 177 Ct. Cl. 227, 336 F.2d 1003 (1966).

10. Id. at 232, F.2d at 1006.

11. UCC, Sec. 2-608(1).

12. K & M Construction Co., Eng BCA 3115, 73-2 BCA ¶ 10,034; Electronic & Missile Facilities, Inc., GSBCA 2787, 71-1 BCA ¶ 8785 (1971).

13. Standard Form 23A, Clause 10(b) and (c).
Standard Form 32, Clause 5(b).

14. Id.

15. Id.

16. ASBCA 21054, 77-2 BCA ¶ 12,667 (1977).

17. The Government was, however allowed a reduction in price in the amount the contractor saved by not being required to make corrections. Such a reduction was allowed on the basis of a deductive constructive change.

18. VACAB 1133, 77-1 BCA ¶ 12,427 (1977).

19. See also Reynolds Metals Co., IBCA 484-3-65, 66-1 BCA ¶ 5566 (1966).

20. Standard Form 23A, Clause 10(b);
Standard Form 32, Clause 5(b).

21. Bruner, Inspection, Acceptance & Warranties, Developments in Government Contract Law 1976, p. 209. ABA Section on Public Contract Law (1977); Bar-Ray Products, Inc. v. United States, 162 Ct. Cl. 836, 340 F.2d 343 (1964).

22. Frosty Morn Meats, Inc., ASBCA 4221, 58-1 BCA ¶ 1746 (1958).

23. Platt Manufacturing Co., ASBCA 19906, 19907, 76-2 BCA ¶ 12,016 (1976).

24. Standard Form 23A, Clause 10(c);
Standard Form 32, Clause 5(b).

25. ASBCA 3385, 57-1 BCA ¶ 1242 (1957).

26. Id. at 3598.

27. See also Triple A Machine Shop, Inc., ASBCA 16844, 73-1 BCA ¶ 9826 (1972).

28. IBCA 442-6-64, 65-2 BCA ¶ 4974 (1965).

29. Philos Construction Co., DOTCAB 67-33, 68-2 BCA ¶ 7110 (1968).

30. ASBCA 9839, 72-2 BCA ¶ 9507 (1972), at 44,296.

31. Standard Form 23A, Clause 10(d);
Standard Form 32, Clause 5(c).

32. Harrington & Richardson, supra n. 30.

33. 203 Ct. Cl. 182, 488 F.2d 980 (1973).

34. 469 F.2d 1003 (5th Cir. 1972).

35. 482 F.2d 400 (9th Cir. 1973), cert. denied 415 U.S. 918 (1974).

36. Rollie Clemence, ASBCA 3285, 58-1 BCA ¶ 1722 (1958).

37. Standard Form 23A, Clause 5(a).

38. Standard Form 23A, Clause 5(b).

39. Standard Form 32, Clause 11(b).

40. Lome Electronics, Inc., ASBCA 8642, 1963 BCA ¶ 3833 (1963).

41. Associated Traders Inc. V. United States, 144 Ct. Cl. 744, 169 F. Supp. 502 (1959).

42. Francis M. Marley v. United States, 191 Ct. Cl. 205, 423 F.2d 324 (1970).

43. Harrington & Richardson, supra n. 30; A & W General Cleaning Contractors, ASBCA 14809, 71-2 BCA ¶ 8994 (1971).

44. Rumley v. United States, 285 F.2d 773 (1961).

45. Bruner, supra n. 21; Standard Form 23A, Clause 10(b).

46. ASPR 14-406(d).

47. Famous Model Co., ASBCA 12526, 68-1 BCA ¶ 6902 (1968).

48. 167 Ct. Cl. 839, 340 F.2d 343 (1964).

49. Supra n. 6 at 43,370.

50. Teltron, Inc., ASBCA 14894, 72-2 BCA ¶ 9502 (1972).

51. Atlantic Hardware & Supply Corp., ASBCA 10450, 66-1 BCA ¶ 5378 (1966).

52. D. Dobbs, Handbook on the Law of Remedies (1973).

53. A. Corbin, Contracts, Sec. 1104 (1964).

54. See UCC, § 2-608, Comment 1.

55. GSBCA 4662, 77-2 BCA ¶ 12,664 (1977).

56. Id. at 61,396.

57. ASPR 7-105.7; ASPR 7-604.4.

58. United States v. Aerodex, supra n. 34; Mallory Engineering, Inc., DCAB No. AA-1-77, 77-2 BCA ¶ 12,745 (1977).

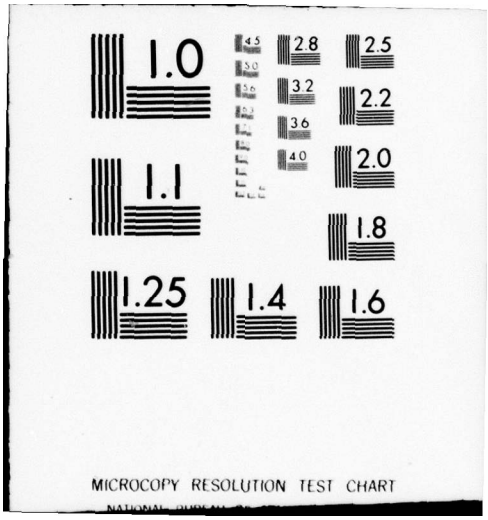
59. ASBCA 13271, 71-1 BCA ¶ 8727 (1971).

AD-A065 485 AIR FORCE INST OF TECH WRIGHT-PATTERSON AFB OHIO F/G 5/1
POST-ACCEPTANCE LIABILITY FOR LATENT DEFECTS, FRAUD AND GROSS M--ETC(U)
SEP 78 L B HOLT

UNCLASSIFIED AFIT-CI-79-105T NL

2 OF 2
AD
A065485

END
DATE
FILMED
4-79
DDC


1.0
1.1
1.25
1.4
1.6
1.8
2.0
2.2
2.5
2.8
3.2
3.6
4.0
4.5
5.0
5.6
MICROCOPY RESOLUTION TEST CHART

60. Id. at 40,539; see also Fire Detection Service, Inc., IBCA No. 901-4-71, 72-1 BCA ¶ 9835 (1972).

61. DOTCAB 67-33, 68-2 BCA ¶ 7110 (1968).

62. Id. at 32,939, n. 22.

CHAPTER FOUR

PROPOSALS FOR CHANGE

In late 1972, the Federal Procurement Regulation Staff of the General Services Administration proposed significant and radical changes to the exceptions to finality provisions of the standard Inspection clause for fixed-price supply contracts.[1] Following extensive internal debate and certain alterations, the Armed Services Procurement Regulation Committee on November 15, 1977 also recommended that the proposed changes be adopted.[2] Specific amendments to the Federal Procurement Regulations and the Armed Services Procurement Regulation were subsequently proposed and are currently being considered as part of the overall attempt to develop a new unified federal acquisition system.[3] Among the changes proposed, the most significant include a new fourth exception to the finality of acceptance for patent defects, a six-year time limit for a claim based upon latent defects, and the establishment of a separate set of post-acceptance Government remedies. The following sections will analyze the proposed changes and will discuss whether they should and will be adopted.

Patent Defects as A New Exception to the Finality of Acceptance

The most controversial proposal for change to the standard Inspection clause for fixed-price supply contracts is the addition of a new exception to finality of acceptance for patent defects that indicate a failure of the contractor to comply with his inspection and record-keeping responsibilities.

As a foundation for the proposed establishment of a patent defects exception to the finality of acceptance, the standard Inspection clause as contained in Standard Form 32 would initially be changed to provide a totally new subparagraph 5(a). The proposed subparagraph states that the contractor is responsible for controlling product quality, tendering supplies that conform to contract requirements, and maintaining and furnishing evidence substantiating this conformance. In order to effect this control, the clause provides that the contractor would have to establish and comply with an inspection system, the acceptability and evaluation of which will be subject to review and evaluation by the Government.[4] In addition, the contractor would be required to keep records of all inspections and make them available to the Government.[5] It can be seen that the new subparagraph 5(a) would combine many requirements already stated in other ASPR provisions and place them in the Inspection clause.

Based upon the above stated provisions of subparagraph

5(a), a new fourth exception to the finality of acceptance for patent defects would be provided in subparagraph 5(e) of the proposed Inspection clause. Current exceptions to finality for latent defects, fraud, and gross mistakes amounting to fraud would be included as now stated in subparagraph 5(d). The proposed subparagraph 5(e) provides that "Acceptance shall be conclusive except for . . . (4) patent defects not revealed prior to acceptance, the quantity or nature of which, when considered in conjunction with the contractor's obligations to deliver acceptable supplies and maintain records under paragraph 5(a) hereof, shall be deemed a failure to comply with the inspection and records provisions of the contract."[6] In addition, in order for the new exception to apply, the proposed subparagraph 5(e) also provides that the contracting officer must find that (a) the defects or nonconformance were not caused after acceptance by factors outside the contractor's control, and (b) the contractor has been notified of the defects or nonconformance not later than six months after acceptance of the supplies or lots of supplies of the type containing such patent defects last delivered under the contract.[7] A parallel change to FPR Section 1-14.206 has been proposed which also affects the contracting officer's consideration of the new patent defects exception, but which is not reflected in the proposed Inspection clause. The proposed change to FPR Section 1-14.206 would provide that where material is

accepted, and (a) the contract requires that the contractor maintain an acceptable inspection system; (b) the contractor's records indicate that the supplies meet contract requirements; and (c) patent defects are discovered after acceptance, "A finding may be made that the contractor has not in fact maintained an acceptable inspection system with appropriate records."[8]

The Government has stated that the major purpose behind the new patent defects exception to finality of acceptance is to address "the problem created by contractor delivery of non-specification supplies, particularly in the presence of a discrepancy between the condition of the supplies delivered and the condition reported in the contractor's own inspection records regarding conformance to contract requirements."[9] The Government contends that numerous patent defects are not being discovered because of the Government's reliance on the contractor's inspection system and records which often incorrectly reflect contract compliance. It is argued that the basis of this problem is the belief by some contractors that the Government will determine contract compliance and the method of inspection, and that therefore any supplies not rejected can automatically be considered satisfactory.[10] In response to these problems, the proposed Inspection clause is structured so that the responsibility for inspections, contract compliance, and the documentation of both, is clearly placed on the contractor. If patent defects discovered after

acceptance indicate by their number or type that these responsibilities have not been fulfilled by the contractor, then finality of acceptance does not apply.

The industry response to the proposed patent defect exception to finality has been totally critical. The Council of Defense and Space Industry Associations (CODSIA), for example, has stated that "The proposed fourth exception is unsound and an improper and unjustified undermining of the long established conclusiveness of acceptance."[11] Although the CODSIA view may seem overly condemning, the proposed patent defect exception to finality does appear to undermine the established principles upon which the concept of conclusiveness of acceptance is based. As indicated in the *Introduction to this thesis*, the standard Inspection clause embodies a compromise between the Government's desire to conduct extensive inspection and the contractor's desire to limit his post-acceptance liability. Unlike the commercial world therefore, the standard Inspection clause provides for extensive Government inspection and also removes the contractor's liability following acceptance for damages or breach of implied warranties due to nonconforming supplies; except for latent defects, fraud, and gross mistakes amounting to fraud. When the patent defects exception is added, and joined with extensive requirements for contractor inspection, the contractor is exposed to a far greater degree of possible post-acceptance liability for at least six months

following acceptance. The balance between the Government's right to inspect and the limitation on the contractor's post-acceptance liability is therefore destroyed. The Government in no way intends to lessen its right of inspection but expects to "have its cake and eat it too." This is the "best of both worlds." Not only does the Government maintain its extensive right of inspection, but a new basis for revoking acceptance is created when the contractor fails to demonstrate that it has properly conducted inspections which the Government directly approves and controls. The Government would no longer need to conduct inspections but could still subject the contractor to extensive pre-acceptance inspection if desired. The net result may be that the Government will become totally ineffective in its inspection efforts and rely mainly on its post-acceptance remedies.

The effect of the proposed patent defect exception to finality when combined with the currently provided exceptions, is to also create a general warranty for six months following acceptance. This is not accomplished, however, on a selective basis in accordance with stated criteria as must be done with specific warranties under regulatory provisions such as ASPR 1-324.3. The most significant criteria that would not be considered is the cost impact to the Government when the majority of fixed-price supply contracts are required to contain the proposed patent defect exception to finality.

Although the Government has argued that "the cost of useless goods is greater than the price paid for them,"[12] this simplistic answer to the question of costs only indicates a true lack of understanding of the potential price increases that could occur.

The specific language of the proposed patent defects exception, and the apparent conflict between some of this language and the proposed parallel change to FPR 1-14.206, will in addition definitely initiate extensive litigation. The language of the clause, for instance, provides an exception to finality for patent defects, "the quantity and nature of which" indicate a "failure to comply with the inspection and records provisions of the contract."[13] Apparently, liability for a patent defect will survive acceptance if there have been so many similar defects, or if the defect is so obvious or gross that it could not be concluded that the contractor had an adequate inspection and records system. This language, however, clearly leaves a great deal of room for varied interpretations. A large new body of law will have to be developed to give guidance as to how many defects are of sufficient quantity and what type of defects are of the appropriate nature to indicate a poor inspection system. It can easily be seen that the contracting officer who attempts to apply this ambiguous language to actual defects will probably encounter a significant number of appeals. In addition, the proposed changes to FPR 1-14.206

apparently conflict with the above discussed provision of Section 5(e) and would allow the contracting officer to find that liability for a patent defect survives acceptance, even though there is no finding that the quantity and nature of the defect evidenced a failure to comply with the inspection requirements of the contract. The proposed amendment to FPR 1-14.206 previously outlined would allow the contracting officer to find that the contractor did not in fact maintain an acceptable inspection system simply because a patent defect was discovered when the contractor's record system indicated that the supplies met the contract requirements.[14] Under this system, the contractor can never win. If the product is bad, but the contractor's records indicate it is good, the contracting officer can find a failure to maintain a proper inspection system. If the product is bad, and the contractor's records indicate it is bad, then the contractor may be liable for fraud or a gross mistake amounting to fraud. In any event, the proposed change to FPR 1-14.206 certainly creates a litigable issue as to the actual criteria to be applied when considering the proposed patent defect exception to finality.

A Time Limit on Claims for Latent Defects

The proposed changes to the standard Inspection clause of Standard Form 32 also provide that post-acceptance claims for latent defects will be limited to six years. Section 5(e) of the proposed Inspection clause states that "acceptance

shall be conclusive except as regards (1) latent defects discovered within six years after final payment."[15] The intended purpose of this change was to give something to the contractor in order to facilitate his acceptance of the patent defects provisions described above. The Government admits, however, that very little was given. A General Services Administration position paper on the proposed Inspection clause, for example, clearly states that "In practice, the provability of latent defects decreases rapidly with the passage of time," and "DOD has granted many deviations to the unlimited exception for major contractors."[16] In spite of the accuracy of the above-quoted statements, the ASPR Committee strongly opposed such a limitation when it was originally proposed.[17] It was the position of the ASPR Committee that although a time limitation would be fair and equitable to the contractor, there was little equity for the Government.[18] The ASPR Committee finally agreed when the originally proposed time limit was changed from three years to six. Although members of the industry agreed to the original three-year time limitation,[19] they have not agreed to the six-year limitation as currently proposed.

Since the proposed six-year time limit for latent defects has little effect on the Government, and in turn affords little protection to the contractor, it is of little consequence in obtaining the ultimate objective of acquiring

quality products at a reasonable price. If an effective compromise is to be made, whether as a tradeoff for post-acceptance liability for patent defects or as an equitable allocation of risk, it cannot be based upon a useless alteration in the present clause.

Establishment of Separate Remedies for Defects Discovered after Acceptance

The proposed standard Inspection clause for fixed-price supply contracts also provides for a new Section 5(f) which would establish separate post-acceptance remedies when acceptance is revoked due to the four stated exceptions to finality. The current two-step remedial system as previously discussed would only be applied during pre-acceptance.

Under the proposed new Section 5(f), if acceptance is revoked due to one of the four exceptions to finality, the Government could require correction or replacement in accordance with a new delivery schedule, or return the goods and demand a refund of amounts previously paid. If the Government demands correction or replacement, and the contractor does not do so, the Government could also seek an equitable reduction in price and retain the goods. In addition, if the contractor fails to either correct or replace, agree to a reduction in price, or refund amounts paid, as may be required, the Government could also by contract or otherwise obtain correction or replacement and charge such costs to the contractor.[20]

It can be seen that two important differences from the current remedial system are contained in the proposed post-acceptance remedies. First, a restitutionary remedy is provided as an alternative to initially demanding correction and replacement. Through this restitutionary remedy, if the Government does not desire correction or replacement, it may demand repayment of the purchase price directly under the Inspection clause. It is to be noted, however, that if the contractor refuses to refund the money, the Government may then only obtain correction or replacement itself and cannot seek an equitable reduction in price. The latter remedy is only available where the contractor refuses to correct or replace as requested. The second important difference is the lack of any provision for default termination and the corresponding right to excess cost of reprocurement.

The establishment of a separate post-acceptance remedial system, and the inclusion of a restitutionary remedy and exclusion of the default remedy, is reflective of the view of both Government and industry that in many cases the current remedies are not suited for a post-acceptance situation. In certain instances, for example, the Government may not wish to deal further with the contractor that has delivered defective goods that were accepted due to fraud or gross mistakes amounting to fraud. The Government's needs or requirements may also have changed

and correction or replacement may not be desired. In such cases, a restitutionary remedy is appropriate. Although restitution has been consistently utilized outside of the standard Inspection clause, the Government has argued that inclusion of a specific restitutionary remedy within the clause will clarify its use and give the Government a needed alternative post-acceptance contractual remedy.[21] Industry on the other hand has argued that termination for default as provided for in the standard Inspection clause is not an appropriate remedy in the post-acceptance situation.[22]

Either through compromise or merit, the Government wisely deleted the default provision in exchange for the post-acceptance restitutionary remedy. The proposed remedial provisions are a needed and useful clarification of the Government's rights and the contractor's liability in the pre- and post-acceptance environment. It recognizes legitimate differences in the two situations and establishes an equitable and effective remedial structure for each.

Should and Will the Changes Be Adopted?

With the exception of the proposal for separate post-acceptance remedies, the proposed changes to the standard Inspection clause will not be beneficial to either the Government or the contractor and should not be adopted. The proposal to add an exception to finality of acceptance

for patent defects that indicate a failure to comply with the contractor's inspection responsibility will be extremely difficult to apply and may unfairly shift a greater risk to the contractor without a corresponding benefit in return. If the real problem is the inability of the Government to efficiently conduct pre-acceptance inspections or manage quality-assurance programs, the solution is to either protect the Government by purchasing a true warranty or significantly expanding the Government's pre-acceptance inspection role. A hybrid solution as proposed will not render the benefits of either.

The proposed six-year limitation for latent-defect claims is also unacceptable in that it changes very little and is a useless gesture. Since latent defect claims are rarely asserted beyond six years following acceptance, the rights of the Government and liabilities of the contractor are unaffected.

In spite of the serious problems described above, the official position of both the Federal Procurement Regulation Staff and the Armed Services Procurement Committee remains for adoption. Internal waters, however, are in reality not so smooth and indicate the unlikelihood of such adoption. Counsel for the General Services Administration, for example, has indicated serious reservations about the proposed clause and feels that a tremendous increase in litigation may occur due to the vague and ambiguous language.[23] Similarly, the

ASPR Subcommittee on Warranties has continued to recommend that the clause not be approved in spite of the full ASPR Committee approval.[24] Industry has also, of course, strongly indicated their disapproval of the proposed patent defect exception and can present a formidable barrier to adoption. The most important indication, however, that the proposed clause will not be adopted is the position of the Office of Federal Procurement Policy that in formulating the new Federal Acquisition system, the Uniform Commercial Code should be used to the greatest extent possible.[25] This position, of course, is contrary to both the proposed and current standard Inspection clause provisions for post-acceptance liability and would suggest a limited right of inspection, the application of implied warranties, and revocation of acceptance within a reasonable time only for substantial nonconformities.[26]

CHAPTER FOUR

FOOTNOTES

1. The Government Contractor, Vol. 15, No. 21, Oct. 15, 1973.

2. ASPR Committee Letter, Nov. 15, 1977, to Mr. Philip G. Read, Dir. of Federal Procurement Regulations, Office of Procurement Management, General Services Admin.

3. ASPR Committee Case File No. 73-18, Latent Defects.

4. Proposed Inspection Clause, General Services Admin. Position Paper, Finality of Acceptance--Project FPR 319, Dec. 1977.

5. Id.

6. Supra n. 4 at attachment.

7. Supra n. 4.

8. General Services Admin. Director of Federal Procurement Regulations Letter, March 14, 1975, to Council of Defense and Space Industry Associations (CODSIA).

9. Id. at 1.

10. Supra n. 4.

11. Council of Defense and Space Industry Associations (CODSIA) Letter, May 28, 1975, to Mr. Philip G. Read, Director of Federal Procurement Regulations, Office of Procurement Management, General Services Admin.

12. Supra n. 4, at 2.

13. Supra n. 4, at attachment.

14. Supra n. 8.

15. Supra n. 4, at attachment.

16. Supra n. 4, at 2.

17. ASPR Committee Position Paper, ASPR Case 73-18.

18. Id.

19. Supra n. 11.

20. Supra n. 4.

21. Id.

22. Supra n. 11.

23. Interview with Mr. Jack Miller, General Counsel, Federal Procurement Regulations, General Services Admin.

24. Supra n. 3.

25. Administrator of the Office of Federal Procurement Policy Letter, January 31, 1978, to The Hon. Joel W. Solomon, Administrator of the General Services Admin.

26. UCC, § 2-607; UCC, § 2-608.

CONCLUSION

The Government has generally had very limited success in establishing the existence of latent defects, fraud, or gross mistakes amounting to fraud. Board and court decisions have created complicated elements of proof and have placed a very heavy burden upon the Government. As a result, the subject exceptions to finality of acceptance have afforded very little protection against the inability of the Government to discover certain types of defects during pre-acceptance inspection and testing.

In spite of the lack of success with current exceptions to finality of acceptance, a serious proposal has been made to add a new exception for patent defects that reflect a failure of the contractor to adequately comply with the quality-assurance provision of the contract. This proposal appears to be based on the realization that current Government inspection and quality-control programs have not succeeded in insuring contract compliance. If such is the case, there may be a definite need to reassess the Government's dependence on pre-acceptance inspection and post-acceptance exceptions to finality of acceptance. The answer may be to reduce this dependence and to reestablish the traditional post-acceptance remedies as provided by the common law or the Uniform Commercial Code.

APPENDIX

GENERAL PROVISIONS

(Construction Contract)

1. DEFINITIONS

(a) The term "head of the agency" or "Secretary" as used herein means the Secretary, the Under Secretary, any Assistant Secretary, or any other head or assistant head of the executive or military department or other Federal agency; and the term "his duly authorized representative" means any person or persons or board (other than the Contracting Officer) authorized to act for the head of the agency or the Secretary.

(b) The term "Contracting Officer" as used herein means the person executing this contract on behalf of the Government and includes a duly appointed successor or authorized representative.

2. SPECIFICATIONS AND DRAWINGS

The Contractor shall keep on the work a copy of the drawings and specifications and shall at all times give the Contracting Officer access thereto. Anything mentioned in the specifications and not shown on the drawings, or shown on the drawings and not mentioned in the specifications, shall be of like effect as if shown or mentioned in both. In case of difference between drawings and specifications, the specifications shall govern. In case of discrepancy either in the figures, in the drawings, or in the specifications, the matter shall be promptly submitted to the Contracting Officer, who shall promptly make a determination in writing. Any adjustment by the Contractor without such a determination shall be at his own risk and expense. The Contracting Officer shall furnish from time to time such detail drawings and other information as he may consider necessary, unless otherwise provided.

3. CHANGES

(a) The Contracting Officer may, at any time, without notice to the sureties, by written order designated or indicated to be a change order, make any change in the work within the general scope of the contract, including but not limited to changes:

(1) In the specifications (including drawings and designs);

(2) In the method or manner of performance of the work;

(3) In the Government-furnished facilities, equipment, materials, services, or site; or

(4) Directing acceleration in the performance of the work.

(b) Any other written order or an oral order (which terms as used in this paragraph (b) shall include direction, instruction, interpretation, or determination) from the Contracting Officer, which causes any such change, shall be treated as a change order under this clause, provided that the Contractor gives the Contracting Officer written notice stating the date, circumstances, and source of the order and that the Contractor regards the order as a change order.

(c) Except as herein provided, no order, statement, or conduct of the Contracting Officer shall be treated as a change under this clause or entitle the Contractor to an equitable adjustment hereunder.

(d) If any change under this clause causes an increase or decrease in the Contractor's cost of, or the time required for, the performance of any part of the work under this contract, whether or not changed by any order, an equitable adjustment shall be made and the contract modified in writing accordingly: *Provided, however,* That except for claims based on defective specifications, no claim for any change under (b) above shall be allowed for any costs incurred more than 20 days before the Contractor gives written notice as therein required: *And provided further,* That in the case of defective specifications for which the Government is responsible, the equitable adjustment shall include any increased cost reasonably incurred by the Contractor in attempting to comply with such defective specifications.

(e) If the Contractor intends to assert a claim for an equitable adjustment under this clause, he must, within 30 days after receipt of a written change order under (a) above or the furnishing of a written notice under (b) above, submit to the Contracting Officer a written statement setting forth the general nature and monetary extent of such claim, unless this period is extended by the Government. The statement of claim hereunder may be included in the notice under (b) above.

(f) No claim by the Contractor for an equitable adjustment hereunder shall be allowed if asserted after final payment under this contract.

4. DIFFERING SITE CONDITIONS

(a) The Contractor shall promptly, and before such conditions are disturbed, notify the Contracting Officer in writing of: (1) Subsurface or latent physical conditions at the site differing materially from those indicated in this contract, or (2) unknown physical conditions at the site, of an unusual nature, differing materially from those ordinarily encountered and generally recognized as inhering in work of the character provided for in this contract. The Contracting Officer shall promptly investigate the conditions, and if he finds that such conditions do materially so differ and cause an increase or decrease in the Contractor's cost of, or the time required for, performance of any part of the work under this contract, whether or not changed as a result of such conditions, an equitable adjustment shall be made and the contract modified in writing accordingly.

(b) No claim of the Contractor under this clause shall be allowed unless the Contractor has given the notice required in (a) above; provided, however, the time prescribed therefor may be extended by the Government.

(c) No claim by the Contractor for an equitable adjustment hereunder shall be allowed if asserted after final payment under this contract.

5. TERMINATION FOR DEFAULT—DAMAGES FOR DELAY—TIME EXTENSIONS

(a) If the Contractor refuses or fails to prosecute the work, or any separable part thereof, with such diligence as will insure its completion within the time specified in this contract, or any extension thereof, or fails to complete said work within such time, the Government may, by written notice to the Contractor, terminate his right to proceed with the work or such part of the work as to which there has been delay. In such event the Government may take over the work and prosecute the same to completion, by contract or otherwise, and may take possession of and utilize in completing the work such materials, appliances, and plant as may be on the site of the work and necessary therefor. Whether or not the Contractor's right to proceed with the work is terminated, he and his sureties shall be liable for any damage to the Government resulting from his refusal or failure to complete the work within the specified time.

(b) If fixed and agreed liquidated damages are provided in the contract and if the Government so terminates the Contractor's right to proceed, the resulting damage will consist of such liquidated damages until such reasonable time as may be required for final completion of the work together with any increased costs occasioned the Government in completing the work.

(c) If fixed and agreed liquidated damages are provided in the contract and if the Government does not so terminate the Contractor's right to proceed, the resulting damage will consist of such liquidated damages until the work is completed or accepted.

(d) The Contractor's right to proceed shall not be so terminated nor the Contractor charged with resulting damage if:

(1) The delay in the completion of the work arises from unforeseeable causes beyond the control and without the fault or negligence of the Contractor, including but not restricted to, acts of God, acts of the public enemy, acts of the Government in either its sovereign or contractual capacity, acts of another contractor in the performance of a contract with the Government, fires, floods, epidemics, quarantine restrictions, strikes, freight embargoes, unusually severe weather, or delays of subcontractors or suppliers arising from unforeseeable causes beyond the control and without the fault or negligence of both the Contractor and such subcontractors or suppliers; and

(2) The Contractor, within 10 days from the beginning of any such delay (unless the Contracting Officer grants a further period of time before the date of final payment

nder the contract), notifies the Contracting Officer in riting of the causes of delay.

The Contracting Officer shall ascertain the facts and the ex- t of the delay and extend the time for completing the work w n, in his judgment, the findings of fact justify such an ex- t sion, and his findings of fact shall be final and conclusive on the parties, subject only to appeal as provided in Clause 6 of these General Provisions.

e) If, after notice of termination of the Contractor's right t proceed under the provisions of this clause, it is determined f any reason that the Contractor was not in default under the provisions of this clause, or that the delay was excusable under the provisions of this clause, the rights and obligations o he parties shall, if the contract contains a clause provid- i for termination for convenience of the Government, be t same as if the notice of termination had been issued pur- suant to such clause. If, in the foregoing circumstances, this contract does not contain a clause providing for termination f convenience of the Government, the contract shall be e itably adjusted to compensate for such termination and t contract modified accordingly; failure to agree to any such adjustment shall be a dispute concerning a question of fact within the meaning of the clause of this contract entitled " sputes."

f) The rights and remedies of the Government provided in this clause are in addition to any other rights and remedies provided by law or under this contract.

(g) As used in Paragraph (d) (1) of this clause, the term " bcontractors or suppliers" means subcontractors or sup- p rs at any tier.

6. DISPUTES

(a) Except as otherwise provided in this contract, any dis- p e concerning a question of fact arising under this contract w ch is not disposed of by agreement shall be decided by the Contracting Officer, who shall reduce his decision to writing and mail or otherwise furnish a copy thereof to the Contrac- t The decision of the Contracting Officer shall be final and c clusive unless, within 30 days from the date of receipt of s h copy, the Contractor mails or otherwise furnishes to the Contracting Officer a written appeal addressed to the head of the agency involved. The decision of the head of the agency o his duly authorized representative for the determination of s h appeals shall be final and conclusive. This provision s ll not be pleaded in any suit involving a question of fact arising under this contract as limiting judicial review of any such decision to cases where fraud by such official or his rep- r entative or board is alleged: *Provided, however,* That any s h decision shall be final and conclusive unless the same is f udulent or capricious or arbitrary or so grossly erroneous as necessarily to imply bad faith or is not supported by substantial evidence. In connection with any appeal proceeding u der this clause, the Contractor shall be afforded an oppor- t ity to be heard and to offer evidence in support of his ap- p al. Pending final decision of a dispute hereunder, the Contractor shall proceed diligently with the performance of the contract and in accordance with the Contracting Officer's d ision.

(b) This Disputes clause does not preclude consideration of questions of law in connection with decisions provided for in paragraph (a) above. Nothing in this contract, however, shall be construed as making final the decision of any admin- i ative official, representative, or board on a question of law.

7. PAYMENTS TO CONTRACTOR

(a) The Government will pay the contract price as hereinafter provided.

(b) The Government will make progress payments monthly a the work proceeds, or at more frequent intervals as determined by the Contracting Officer, on estimates approved by the Contracting Officer. If requested by the Contracting Officer, the Contractor shall furnish a breakdown of the total c tract price showing the amount included therein for each p ncipal category of the work, in such detail as requested, to provide a basis for determining progress payments. In the preparation of estimates the Contracting Officer, at his dis- c tion, may authorize material delivered on the site and pre- p atory work done to be taken into consideration. Material d vered to the Contractor at locations other than the site may also be taken into consideration (1) if such consideration is specifically authorized by the contract and (2) if the Con- t ctor furnishes satisfactory evidence that he has acquired t e to such material and that it will be utilized on the work c ered by this contract.

(c) In making such progress payments, there shall be retained 10 percent of the estimated amount until final completion and acceptance of the contract work. However, if the Contracting Officer, at any time after 50 percent of the work has been completed, finds that satisfactory progress is being made, he may authorize payment in full of each progress payment for work performed beyond the 50 percent stage of completion. Also, whenever the work is substantially complete, the Contracting Officer, if he considers the amount retained to be in excess of the amount adequate for the protection of the Government, at his discretion, may release to the Contractor all or a portion of such excess amount. Furthermore, on completion and acceptance of each separate building, public work, or other division of the contract, on which the price is stated separately in the contract, payment may be made therefor without retention of a percentage.

(d) All material and work covered by progress payments made shall thereupon become the sole property of the Government, but this provision shall not be construed as relieving the Contractor from the sole responsibility for all material and work upon which payments have been made or the restoration of any damaged work, or as waiving the right of the Government to require the fulfillment of all of the terms of the contract.

(e) Upon completion and acceptance of all work, the amount due the Contractor under this contract shall be paid upon the presentation of a properly executed voucher and after the Contractor shall have furnished the Government with a release of all claims against the Government arising by virtue of this contract, other than claims in stated amounts as may be specifically excepted by the Contractor from the operation of the release. If the Contractor's claim to amounts payable under the contract has been assigned under the Assignment of Claims Act of 1940, as amended (31 U.S.C. 203, 41 U.S.C. 15), a release may also be required of the assignee.

8. ASSIGNMENT OF CLAIMS

(a) Pursuant to the provisions of the Assignment of Claims Act of 1940, as amended (31 U.S.C. 203, 41 U.S.C. 15), if this contract provides for payments aggregating $1,000 or more, claims for moneys due or to become due the Contractor from the Government under this contract may be assigned to a bank, trust company, or other financing institution, including any Federal lending agency, and may thereafter be further assigned and reassigned to any such institution. Any such assignment or reassignment shall cover all amounts payable under this contract and not already paid, and shall not be made to more than one party, except that any such assignment or reassignment may be made to one party as agent or trustee for two or more parties participating in such financing. Unless otherwise provided in this contract, payments to an assignee of any moneys due or to become due under this contract shall not, to the extent provided in said Act, as amended, be subject to reduction or setoff. (The preceding sentence applies only if this contract is made in time of war or national emergency as defined in said Act; and is with the Department of Defense, the General Services Administration, the Energy Research and Development Administration, the National Aeronautics and Space Administration, the Federal Aviation Administration, or any other department or agency of the United States designated by the President pursuant to Clause 4 of the proviso of section 1 of the Assignment of Claims Act of 1940, as amended by the Act of May 15, 1951, 65 Stat. 41.)

(b) In no event shall copies of this contract or of any plans, specifications, or other similar documents relating to work under this contract, if marked "Top Secret," "Secret," or "Confidential," be furnished to any assignee of any claim arising under this contract or to any other person not entitled to receive the same. However, a copy of any part or all of this contract so marked may be furnished, or any information contained therein may be disclosed, to such assignee upon the prior written authorization of the Contracting Officer.

9. MATERIAL AND WORKMANSHIP

(a) Unless otherwise specifically provided in this contract, all equipment, material, and articles incorporated in the work covered by this contract are to be new and of the most suitable grade for the purpose intended. Unless otherwise specifically provided in this contract, reference to any equipment, material, article, or patented process, by trade name, make, or catalog number, shall be regarded as establishing a standard of quality and shall not be construed as limiting competition, and the Contractor may, at his option, use any equipment, material, article, or process, which, in the judgment of the Contracting Officer, is equal to that named. The Contractor shall furnish to the Contracting Officer for his approval the name of the manufacturer, the model number,

and other identifying data and information respecting the performance, capacity, nature, and rating of the machinery and mechanical and other equipment which the Contractor contemplates incorporating in the work. When required by this contract or when called for by the Contracting Officer, the Contractor shall furnish the Contracting Officer for approval full information concerning the material or articles which he contemplates incorporating in the work. When so directed, samples shall be submitted for approval at the Contractor's expense, with all shipping charges prepaid. Machinery, equipment, material, and articles installed or used without required approval shall be at the risk of subsequent rejection.

(b) All work under this contract shall be performed in a skillful and workmanlike manner. The Contracting Officer may, in writing, require the Contractor to remove from the work any employee the Contracting Officer deems incompetent, careless or otherwise objectionable.

10. INSPECTION AND ACCEPTANCE

(a) All work (which term includes but is not restricted to materials, workmanship, and manufacture and fabrication of components) shall be subject to inspection and test by the Government at all reasonable times and at all places prior to acceptance. Any such inspection and test is for the sole benefit of the Government and shall not relieve the Contractor of the responsibility of providing quality control measures to assure that the work strictly complies with the contract requirements. No inspection or test by the Government shall be construed as constituting or implying acceptance. Inspection or test shall not relieve the Contractor of responsibility for damage to or loss of the material prior to acceptance, nor in any way affect the continuing rights of the Government after acceptance of the completed work under the terms of paragraph (f) of this clause, except as hereinabove provided.

(b) The Contractor shall, without charge, replace any material or correct any workmanship found by the Government not to conform to the contract requirements, unless in the public interest the Government consents to accept such material or workmanship with an appropriate adjustment in contract price. The Contractor shall promptly segregate and remove rejected material from the premises.

(c) If the Contractor does not promptly replace rejected material or correct rejected workmanship, the Government (1) may, by contract or otherwise, replace such material or correct such workmanship and charge the cost thereof to the Contractor, or (2) may terminate the Contractor's right to proceed in accordance with the clause of this contract entitled "Termination for Default—Damages for Delay—Time Extensions."

(d) The Contractor shall furnish promptly, without additional charge, all facilities, labor, and material reasonably needed for performing such safe and convenient inspection and test as may be required by the Contracting Officer. All inspection and test by the Government shall be performed in such manner as not unnecessarily to delay the work. Special, full size, and performance tests shall be performed as described in this contract. The Government reserves the right to charge to the Contractor any additional cost of inspection or test when material or workmanship is not ready at the time specified by the Contractor for inspection or test or when reinspection or retest is necessitated by prior rejection.

(e) Should it be considered necessary or advisable by the Government at any time before acceptance of the entire work to make an examination of work already completed, by removing or tearing out same, the Contractor shall, on request, promptly furnish all necessary facilities, labor, and material. If such work is found to be defective or nonconforming in any material respect, due to the fault of the Contractor or his subcontractors, he shall defray all the expenses of such examination and of satisfactory reconstruction. If, however, such work if found to meet the requirements of the contract, an equitable adjustment shall be made in the contract price to compensate the Contractor for the additional services involved in such examination and reconstruction and, if completion of the work has been delayed thereby, he shall, in addition, be granted a suitable extension of time.

(f) Unless otherwise provided in this contract, acceptance by the Government shall be made as promptly as practicable after completion and inspection of all work required by this contract, or that portion of the work that the Contracting Officer determines can be accepted separately. Acceptance shall be final and conclusive except as regards latent defects, fraud, or such gross mistakes as may amount to fraud, or as regards the Government's rights under any warranty or guarantee.

11. SUPERINTENDENCE BY CONTRACTOR

The Contractor, at all times during performance and until the work is completed and accepted, shall give his personal superintendence to the work or have on the work a competent superintendent, satisfactory to the Contracting Officer and with authority to act for the Contractor.

12. PERMITS AND RESPONSIBILITIES

The Contractor shall, without additional expense to the Government, be responsible for obtaining any necessary licenses and permits, and for complying with any applicable Federal, State, and municipal laws, codes, and regulations, in connection with the prosecution of the work. He shall be similarly responsible for all damages to persons or property that occur as a result of his fault or negligence. He shall take proper safety and health precautions to protect the work, the workers, the public, and the property of others. He shall also be responsible for all materials delivered and work performed until completion and acceptance of the entire construction work, except for any completed unit of construction thereof which theretofore may have been accepted.

13. CONDITIONS AFFECTING THE WORK

The Contractor shall be responsible for having taken steps reasonably necessary to ascertain the nature and location of the work, and the general and local conditions which can affect the work or the cost thereof. Any failure by the Contractor to do so will not relieve him from responsibility for successfully performing the work without additional expense to the Government. The Government assumes no responsibility for any understanding or representations concerning conditions made by any of its officers or agents prior to the execution of this contract, unless such understanding or representations by the Government are expressly stated in the contract.

14. OTHER CONTRACTS

The Government may undertake or award other contracts for additional work, and the Contractor shall fully cooperate with such other contractors and Government employees and carefully fit his own work to such additional work as may be directed by the Contracting Officer. The Contractor shall not commit or permit any act which will interfere with the performance of work by any other contractor or by Government employees.

15. SHOP DRAWINGS

(a) The term "shop drawings" includes drawings, diagrams, layouts, schematics, descriptive literature, illustrations, schedules, performance and test data, and similar materials furnished by the Contractor to explain in detail specific portions of the work required by the contract.

(b) If this contract requires shop drawings, the Contractor shall coordinate all such drawings, and review them for accuracy, completeness, and compliance with contract requirements and shall indicate his approval thereon as evidence of such coordination and review. Shop drawings submitted to the Contracting Officer without evidence of the Contractor's approval may be returned for resubmission. The Contracting Officer will indicate his approval or disapproval of the shop drawings and if not approved as submitted shall indicate his reasons therefor. Any work done prior to such approval shall be at the Contractor's risk. Approval by the Contracting Officer shall not relieve the Contractor from responsibility for any errors or omissions in such drawings, nor from responsibility for complying with the requirements of this contract, except with respect to variations described and approved in accordance with (c) below.

(c) If shop drawings show variations from the contract requirements, the Contractor shall describe such variations in writing, separate from the drawings, at the time of submission. If the Contracting Officer approves any such variation(s), he shall issue an appropriate contract modification, except that, if the variation is minor and does not involve a change in price or in time of performance, a modification need not be issued.

16. USE AND POSSESSION PRIOR TO COMPLETION

The Government shall have the right to take possession of or use any completed or partially completed part of the work. Prior to such possession or use, the Contracting Officer shall furnish the Contractor an itemized list of work remaining to be performed or corrected on such portions of the project as are to be possessed or used by the Government, provided that failure to list any item of work shall not relieve the Contractor of responsibility for compliance with the terms of the

contract. Such possession or use shall not be deemed an acceptance of any work under the contract. While the Government has such possession or use, the Contractor, notwithstanding the provisions of the clause of this contract entitled "Permits and Responsibilities," shall be relieved of the responsibility for the loss or damage to the work resulting from the Government's possession or use. If such prior possession or use by the Government delays the progress of the work or causes additional expense to the Contractor, an equitable adjustment in the contract price or the time of completion will be made and the contract shall be modified in writing accordingly.

17. SUSPENSION OF WORK

(a) The Contracting Officer may order the Contractor in writing to suspend, delay, or interrupt all or any part of the work for such period of time as he may determine to be appropriate for the convenience of the Government.

(b) If the performance of all or any part of the work is, for an unreasonable period of time, suspended, delayed, or interrupted by an act of the Contracting Officer in the administration of this contract, or by his failure to act within the time specified in this contract (or if no time is specified, within a reasonable time), an adjustment shall be made for any increase in the cost of performance of this contract (excluding profit) necessarily caused by such unreasonable suspension, delay, or interruption and the contract modified in writing accordingly. However, no adjustment shall be made under this clause for any suspension, delay, or interruption to the extent (1) that performance would have been so suspended, delayed, or interrupted by any other cause, including the fault or negligence of the Contractor or (2) for which an equitable adjustment is provided for or excluded under any other provision of this contract.

(c) No claim under this clause shall be allowed (1) for any costs incurred more than 20 days before the Contractor shall have notified the Contracting Officer in writing of the act or failure to act involved (but this requirement shall not apply as to a claim resulting from a suspension order), and (2) unless the claim, in an amount stated, is asserted in writing as soon as practicable after the termination of such suspension, delay, or interruption, but not later than the date of final payment under the contract.

18. TERMINATION FOR CONVENIENCE OF THE GOVERNMENT

If not physically incorporated elsewhere, the clause in Section 1–8.703 of the Federal Procurement Regulations, or paragraph 7–602.29(a) of the Armed Services Procurement Regulation, as applicable, in effect on the date of this contract is hereby incorporated by reference as fully as if set forth at length herein.

19. PAYMENT OF INTEREST ON CONTRACTORS' CLAIMS

(a) If an appeal is filed by the Contractor from a final decision of the Contracting Officer under the Disputes clause of this contract, denying a claim arising under the contract, simple interest on the amount of the claim finally determined owed by the Government shall be payable to the Contractor. Such interest shall be at the rate determined by the Secretary of the Treasury pursuant to Public Law 92–41, 85 Stat. 97, from the date the Contractor furnishes to the Contracting Officer his written appeal under the Disputes clause of this contract, to the date of (1) a final judgment by a court of competent jurisdiction, or (2) mailing to the Contractor of a supplemental agreement for execution either confirming completed negotiations between the parties or carrying out a decision of a board of contract appeals.

(b) Notwithstanding (a) above, (1) interest shall be applied only from the date payment was due, if such date is later than the filing of appeal; and (2) interest shall not be paid for any period of time that the Contracting Officer determines the Contractor has unduly delayed in pursuing his remedies before a board of contract appeals or a court of competent jurisdiction.

20. PRICING OF ADJUSTMENTS

When costs are a factor in any determination of a contract price adjustment pursuant to the Changes clause or any other provision of this contract, such costs shall be in accordance with the contract cost principles and procedures in Part 1–15 of the Federal Procurement Regulations, (41 CFR 1–15) or Section XV of the Armed Services Procurement Regulation, as applicable, which are in effect on the date of this contract.

21. PATENT INDEMNITY

Except as otherwise provided, the Contractor agrees to indemnify the Government and its officers, agents, and employees against liability, including costs and expenses, for infringement upon any Letters Patent of the United States (except Letters Patent issued upon an application which is now or may hereafter be, for reasons of national security, ordered by the Government to be kept secret or otherwise withheld from issue) arising out of the performance of this contract or out of the use or disposal by or for the account of the Government of supplies furnished or construction work performed hereunder.

22. ADDITIONAL BOND SECURITY

If any surety upon any bond furnished in connection with this contract becomes unacceptable to the Government, or if any such surety fails to furnish reports as to his financial condition from time to time as requested by the Government, or if the contract price is increased to such an extent that the penal sum of any bond becomes inadequate in the opinion of the Contracting Officer, the Contractor shall promptly furnish such additional security as may be required from time to time to protect the interests of the Government and of persons supplying labor or materials in the prosecution of the work contemplated by this contract.

23. EXAMINATION OF RECORDS BY COMPTROLLER GENERAL

(a) This clause is applicable if the amount of this contract exceeds $10,000 and was entered into by means of negotiation, including small business restricted advertising, but is not applicable if this contract was entered into by means of formal advertising.

(b) The contractor agrees that the Comptroller General of the United States or any of his duly authorized representatives shall, until the expiration of 3 years after final payment under this contract or such lesser time specified in either Appendix M of the Armed Services Procurement Regulation or the Federal Procurement Regulations Part 1–20, as appropriate, have access to and the right to examine any directly pertinent books, documents, papers, and records of the contractor involving transactions related to this contract.

(c) The Contractor further agrees to include in all his subcontracts hereunder a provision to the effect that the subcontractor agrees that the Comptroller General of the United States or any of his duly authorized representatives shall, until the expiration of 3 years after final payment under the subcontract or such lesser time specified in either Appendix M of the Armed Services Procurement Regulation or the Federal Procurement Regulations Part 1–20, as appropriate, have access to and the right to examine any directly pertinent books, documents, papers, and records of such subcontractor, involving transactions related to the subcontract. The term "subcontract" as used in this clause excludes (1) purchase orders not exceeding $10,000 and (2) subcontracts or purchase orders for public utility services at rates established for uniform applicability to the general public.

(d) The periods of access and examination described in (b) and (c), above, for records which relate to (1) appeals under the "Disputes" clause of this contract, (2) litigation or the settlement of claims arising out of the performance of this contract, or (3) costs and expenses of this contract as to which exception has been taken by the Comptroller General or any of his duly authorized representatives, shall continue until such appeals, litigation, claims, or exceptions have been disposed of.

24. BUY AMERICAN

(a) *Agreement.* In accordance with the Buy American Act (41 U.S.C. 10a–10d), and Executive Order 10582, December 17, 1954 (3 CFR, 1954–58 Comp., p. 230), as amended by Executive Order 11051, September 27, 1962 (3 CFR, 1959–63 Comp., p. 635), the Contractor agrees that only domestic construction material will be used (by the Contractor, subcontractors, materialmen, and suppliers) in the performance of this contract, except for nondomestic material listed in the contract.

(b) *Domestic construction material.* "Construction material" means any article, material, or supply brought to the construction site for incorporation in the building or work. An unmanufactured construction material is a "domestic construction material" if it has been mined or produced in the United States. A manufactured construction material is a "domestic construction material" if it has been manufactured in the United States and if the cost of its components which have been mined, produced, or manufactured in the United States exceeds 50 percent of the cost of all its components. "Component" means any article, material, or supply directly incorporated in a construction material.

(c) *Domestic component.* A component shall be considered to have been "mined, produced, or manufactured in the

United States" (regardless of its source in fact) if the article, material, or supply in which it is incorporated was manufactured in the United States and the component is of a class or kind determined by the Government to be not mined, produced, or manufactured in the United States in sufficient and reasonably available commercial quantities and of a satisfactory quality.

25. EQUAL OPPORTUNITY

(The following clause is applicable unless this contract is exempt under the rules, regulations, and relevant orders of the Secretary of Labor (41 CFR, ch. 60).)

During the performance of this contract, the Contractor agrees as follows:

(a) The Contractor will not discriminate against any employee or applicant for employment because of race, color, religion, sex, or national origin. The Contractor will take affirmative action to ensure that applicants are employed, and that employees are treated during employment, without regard to their race, color, religion, sex, or national origin. Such action shall include, but not be limited to, the following: Employment, upgrading, demotion, or transfer; recruitment or recruitment advertising; layoff or termination; rates of pay or other forms of compensation; and selection for training, including apprenticeship. The Contractor agrees to post in conspicuous places, available to employees and applicants for employment, notices to be provided by the Contracting Officer setting forth the provisions of this Equal Opportunity clause.

(b) The Contractor will, in all solicitations or advertisements for employees placed by or on behalf of the Contractor, state that all qualified applicants will receive consideration for employment without regard to race, color, religion, sex, or national origin.

(c) The Contractor will send to each labor union or representative of workers with which he has a collective bargaining agreement or other contract or understanding, a notice, to be provided by the agency Contracting Officer, advising the labor union or workers' representative of the contractor's commitments under this Equal Opportunity clause, and shall post copies of the notice in conspicuous places available to employees and applicants for employment.

(d) The Contractor will comply with all provisions of Executive Order No. 11246 of September 24, 1965, as amended by Executive Order No. 11375 of October 13, 1967, and of the rules, regulations, and relevant orders of the Secretary of Labor.

(e) The Contractor will furnish all information and reports required by Executive Order No. 11246 of September 24, 1965, as amended by Executive Order No. 11375 of October 13, 1967, and by the rules, regulations, and orders of the Secretary of Labor, or pursuant thereto, and will permit access to his books, records, and accounts by the contracting agency and the Secretary of Labor for purposes of investigation to ascertain compliance with such rules, regulations, and orders.

(f) In the event of the Contractor's noncompliance with the Equal Opportunity clause of this contract or with any of the said rules, regulations, or orders, this contract may be canceled, terminated, or suspended, in whole or in part, and the Contractor may be declared ineligible for further Government contracts in accordance with procedures authorized in Executive Order No. 11246 of September 24, 1965, as amended by Executive Order No. 11375 of October 13, 1967, and such other sanctions may be imposed and remedies invoked as provided in Executive Order No. 11246 of September 24, 1965, as amended by Executive Order No. 11375 of October 13, 1967, or by rule, regulation, or order of the Secretary of Labor, or as otherwise provided by law.

(g) The Contractor will include the provisions of paragraphs (a) through (g) in every subcontract or purchase order unless exempted by rules, regulations, or orders of the Secretary of Labor issued pursuant to Section 204 of Executive Order No. 11246 of September 24, 1965, as amended by Executive Order No. 11375 of October 13, 1967, so that such provisions will be binding upon each subcontractor or vendor. The Contractor will take such action will respect to any subcontract or purchase order as the contracting agency may direct as a means of enforcing such provisions, including sanctions for noncompliance: *Provided, however*, that in the event the Contractor becomes involved in, or is threatened with, litigation with a subcontractor or vendor as a result of such direction by the contracting agency, the Contractor may request the United States to enter into such litigation to protect the interests of the United States.

26. COVENANT AGAINST CONTINGENT FEES

The Contractor warrants that no person or selling agency has been employed or retained to solicit or secure this contract upon an agreement or understanding for a commission, percentage, brokerage, or contingent fee, excepting bona fide employees or bona fide established commercial or selling agencies maintained by the Contractor for the purpose of securing business. For breach or violation of this warranty the Government shall have the right to annul this contract without liability or in its discretion to deduct from the contract price or consideration, or otherwise recover, the full amount of such commission, percentage, brokerage, or contingent fee.

27. OFFICIALS NOT TO BENEFIT

No member of or delegate to Congress or resident Commissioner shall be admitted to any share or part of this contract, or to any benefit that may arise therefrom; but this provision shall not be construed to extend to this contract if made with a corporation for its general benefit.

28. CONVICT LABOR

In connection with the performance of work under this contract, the Contractor agrees not to employ any person undergoing sentence of imprisonment at hard labor except as provided by Public Law 89-176, September 10, 1965 (18 U.S.C. 4082(c)(2)) and Executive Order 11755, December 29, 1973.

29. UTILIZATION OF SMALL BUSINESS CONCERNS

(a) It is the policy of the Government as declared by the Congress that a fair proportion of the purchases and contracts for supplies and services for the Government be placed with small business concerns.

(b) The Contractor agrees to accomplish the maximum amount of subcontracting to small business concerns that the Contractor finds to be consistent with the efficient performance of this contract.

30. UTILIZATION OF MINORITY BUSINESS ENTERPRISES

(a) It is the policy of the Government that minority business enterprises shall have the maximum practicable opportunity to participate in the performance of Government contracts.

(b) The Contractor agrees to use his best efforts to carry out this policy in the award of his subcontracts to the fullest extent consistent with the efficient performance of this contract. As used in this contract, the term "minority business enterprise" means a business, at least 50 percent of which is owned by minority group members or, in case of publicly-owned businesses, at least 51 percent of the stock of which is owned by minority group members. For the purposes of this definition, minority group members are Negroes, Spanish-speaking American persons, American-Orientals, American-Indians, American-Eskimos, and American-Aleuts. Contractors may rely on written representations by subcontractors regarding their status as minority business enterprises in lieu of an independent investigation.

31. FEDERAL, STATE, AND LOCAL TAXES

(a) Except as may be otherwise provided in this contract, the contract price includes all applicable Federal, State and local taxes and duties.

(b) Nevertheless, with respect to any Federal excise tax or duty on the transactions or property covered by this contract, if a statute, court decision, written ruling, or regulation takes effect after the contract date, and—

(1) Results in the Contractor being required to pay or bear the burden of any such Federal excise tax or duty or increase in the rate thereof which would not otherwise have been payable on such transactions or property, the contract price shall be increased by the amount of such tax or duty or rate increase: *Provided*, That the Contractor if requested by the Contracting Officer, warrants in writing that no amount for such newly imposed Federal excise tax or duty or rate increase was included in the contract price as a contingency reserve or otherwise; or

(2) Results in the Contractor not being required to pay or bear the burden of, or in his obtaining a refund or drawback of, any such Federal excise tax or duty which would otherwise have been payable on such transactions or property or which was the basis of an increase in the contract price, the contract price shall be decreased by the amount of the relief, refund, or drawback, or that amount shall be paid to the Government, as directed by the Contracting Officer. The contract price shall be similarly decreased if the Contractor, through his fault or negligence or his failure to follow instructions of the Contract-

ing Officer, is required to pay or bear the burden of, or does not obtain a refund or drawback of, any such Federal excise tax or duty.

(c) No adjustment pursuant to paragraph b above will be made under this contract unless the aggregate amount thereof is or may reasonably be expected to be over $100.00.

(d) As used in paragraph b above, the term "contract date" means the date set for the bid opening, or if this is a negotiated contract, the date of this contract. As to additional supplies or services procured by modification to this contract, the term "contract date" means the date of such modification.

(e) Unless there does not exist any reasonable basis to sustain an exemption, the Government, upon request of the Contractor, without further liability, agrees, except as otherwise provided in this contract, to furnish evidence appropriate to establish exemption from any tax which the Contractor warrants in writing was excluded from the contract price. In addition, the Contracting Officer may furnish evidence to establish exemption from any tax that may, pursuant to this Clause, give rise to either an increase or decrease in the contract price. Except as otherwise provided in this contract, evidence appropriate to establish exemption from duties will be furnished only at the discretion of the Contracting Officer.

(f) The Contractor shall promptly notify the Contracting Officer of matters which will result in either an increase or decrease in the contract price, and shall take action with respect thereto as directed by the Contracting Officer.

U. S. GOVERNMENT PRINTING OFFICE : 1978 O - 261-981

GENERAL PROVISIONS

(Supply Contract)

1. DEFINITIONS

As used throughout this contract, the following terms shall have the meaning set forth below:

(a) The term "head of the agency" or "Secretary" as used herein means the Secretary, the Under Secretary, any Assistant Secretary, or any other head or assistant head of the executive or military department or other Federal agency; and the term "his duly authorized representative" means any person or persons or board (other than the Contracting Officer) authorized to act for the head of the agency or the Secretary.

(b) The term "Contracting Officer" means the person executing this contract on behalf of the Government, and any other officer or civilian employee who is a properly designated Contracting Officer; and the term includes, except as otherwise provided in this contract, the authorized representative of a Contracting Officer acting within the limits of his authority.

(c) Except as otherwise provided in this contract, the term "subcontracts" includes purchase orders under this contract.

2. CHANGES

The Contracting Officer may at any time, by a written order, and without notice to the sureties, make changes, within the general scope of this contract, in any one or more of the following: (i) Drawings, designs, or specifications, where the supplies to be furnished are to be specially manufactured for the Government in accordance therewith; (ii) method of shipment or packing; and (iii) place of delivery. If any such change causes an increase or decrease in the cost of, or the time required for, the performance of any part of the work under this contract, whether changed or not changed by any such order, an equitable adjustment shall be made in the contract price or delivery schedule, or both, and the contract shall be modified in writing accordingly. Any claim by the Contractor for adjustment under this clause must be asserted within 30 days from the date of receipt by the Contractor of the notification of change: *Provided, however,* That the Contracting Officer, if he decides that the facts justify such action, may receive and act upon any such claim asserted at any time prior to final payment under this contract. Where the cost of property made obsolete or excess as a result of a change is included in the Contractor's claim for adjustment, the Contracting Officer shall have the right to prescribe the manner of disposition of such property. Failure to agree to any adjustment shall be a dispute concerning a question of fact within the meaning of the clause of this contract entitled "Disputes." However, nothing in this clause shall excuse the Contractor from proceeding with the contract as changed.

3. EXTRAS

Except as otherwise provided in this contract, no payment for extras shall be made unless such extras and the price therefor have been authorized in writing by the Contracting Officer.

4. VARIATION IN QUANTITY

No variation in the quantity of any item called for by this contract will be accepted unless such variation has been caused by conditions of loading, shipping, or packing, or allowances in manufacturing processes, and then only to the extent, if any, specified elsewhere in this contract.

5. INSPECTION

(a) All supplies (which term throughout this clause includes without limitation raw materials, components, intermediate assemblies, and end products) shall be subject to inspection and test by the Government, to the extent practicable at all times and places including the period of manufacture, and in any event prior to acceptance.

(b) In case any supplies or lots of supplies are defective in material or workmanship or otherwise not in conformity with the requirements of this contract, the Government shall have the right either to reject them (with or without instructions as to their disposition) or to require their correction. Supplies or lots of supplies which have been rejected or required to be corrected shall be removed or, if permitted or required by the Contracting Officer, corrected in place by and at the expense of the Contractor promptly after notice, and shall not thereafter be tendered for acceptance unless the former rejection or requirement of correction is disclosed. If the Contractor fails promptly to remove such supplies or lots of supplies which are required to be removed, or promptly to replace or correct such supplies or lots of supplies, the Government either (i) may by contract or otherwise replace or correct such supplies and charge to the Contractor the cost occasioned the Government thereby, or (ii) may terminate this contract for default as provided in the clause of this contract entitled "Default." Unless the Contractor corrects or replaces such supplies within the delivery schedule, the Contracting Officer may require the delivery of such supplies at a reduction in price which is equitable under the circumstances. Failure to agree to such reduction of price shall be a dispute concerning a question of fact within the meaning of the clause of this contract entitled "Disputes."

(c) If any inspection or test is made by the Government on the premises of the Contractor or a subcontractor, the Contractor without additional charge shall provide all reasonable facilities and assistance for the safety and convenience of the Government inspectors in the performance of their duties. If Government inspection or test is made at a point other than the premises of the Contractor or a subcontractor, it shall be at the expense of the Government except as otherwise provided in this contract: *Provided,* That in case of rejection the Government shall not be liable for any reduction in value of samples used in connection with such inspection or test. All inspections and tests by the Government shall be performed in such a manner as not to unduly delay the work. The Government reserves the right to charge to the Contractor any additional cost of Government inspection and test when supplies are not ready at the time such inspection and test is requested by the Contractor or when reinspection or retest is necessitated by prior rejection. Acceptance or rejection of the supplies shall be made as promptly as practicable after delivery except as otherwise provided in this contract; but failure to inspect and accept or reject supplies shall neither relieve the Contractor from responsibility for such supplies as are not in accordance with the contract requirements nor impose liability on the Government therefor.

(d) The inspection and test by the Government of any supplies or lots thereof does not relieve the Contractor from any responsibility regarding defects or other failures to meet the contract requirements which may be discovered prior to acceptance. Except as otherwise provided in this contract, acceptance shall be conclusive except as regards latent defects, fraud, or such gross mistakes as amount to fraud.

(e) The Contractor shall provide and maintain an inspection system acceptable to the Government covering the supplies hereunder. Records of all inspection work by the Contractor shall be kept complete and available to the Government during

the performance of this contract and for such longer period as may be specified elsewhere in this contract.

6. RESPONSIBILITY FOR SUPPLIES

Except as otherwise provided in this contract, (i) the Contractor shall be responsible for the supplies covered by this contract until they are delivered at the designated delivery point, regardless of the point of inspection; (ii) after delivery to the Government at the designated point and prior to acceptance by the Government or rejection and giving notice thereof by the Government, the Government shall be responsible for the loss or destruction of or damage to the supplies only if such loss, destruction, or damage results from the negligence of officers, agents, or employees of the Government acting within the scope of their employment; and (iii) the Contractor shall bear all risks as to rejected supplies after notice of rejection, except that the Government shall be responsible for the loss, or destruction of, or damage to the supplies only if such loss, destruction or damage results from the gross negligence of officers, agents, or employees of the Government acting within the scope of their employment.

7. PAYMENTS

The Contractor shall be paid, upon the submission of proper invoices or vouchers, the prices stipulated herein for supplies delivered and accepted or services rendered and accepted, less deductions, if any, as herein provided. Unless otherwise specified, payment will be made on partial deliveries accepted by the Government when the amount due on such deliveries so warrants; or, when requested by the Contractor, payment for accepted partial deliveries shall be made whenever such payment would equal or exceed either $1,000 or 50 percent of the total amount of this contract.

8. ASSIGNMENT OF CLAIMS

(a) Pursuant to the provisions of the Assignment of Claims Act of 1940, as amended (31 U.S.C. 203, 41 U.S.C. 15), if this contract provides for payments aggregating $1,000 or more, claims for moneys due or to become due the Contractor from the Government under this contract may be assigned to a bank, trust company, or other financing institution, including any Federal lending agency, and may thereafter be further assigned and reassigned to any such institution. Any such assignment or reassignment shall cover all amounts payable under this contract and not already paid, and shall not be made to more than one party, except that any such assignment or reassignment may be made to one party as agent or trustee for two or more parties participating in such financing. Unless otherwise provided in this contract, payments to an assignee of any moneys due or to become due under this contract shall not, to the extent provided in said Act, as amended, be subject to reduction or setoff. (The preceding sentence applies only if this contract is made in time of war or national emergency as defined in said Act and is with the Department of Defense, the General Services Administration, the Energy Research and Development Administration, the National Aeronautics and Space Administration, the Federal Aviation Administration, or any other department or agency of the United States designated by the President pursuant to Clause 4 of the proviso of section 1 of the Assignment of Claims Act of 1940, as amended by the Act of May 15, 1951, 65 Stat. 41.)

(b) In no event shall copies of this contract or of any plans, specifications, or other similar documents relating to work under this contract, if marked "Top Secret," "Secret," or "Confidential," be furnished to any assignee of any claim arising under this contract or to any other person not entitled to receive the same. However, a copy of any part or all of this contract so marked may be furnished, or any information contained therein may be disclosed, to such assignee upon the prior written authorization of the Contracting Officer.

9. ADDITIONAL BOND SECURITY

If any surety upon any bond furnished in connection with this contract becomes unacceptable to the Government or if any such surety fails to furnish reports as to his financial condition from time to time as requested by the Government, the Contractor shall promptly furnish such additional security as may be required from time to time to protect the interests of the Government and of persons supplying labor or materials in the prosecution of the work contemplated by this contract.

10. EXAMINATION OF RECORDS BY COMPTROLLER GENERAL

(a) This clause is applicable if the amount of this contract exceeds $10,000 and was entered into by means of negotiation, including small business restricted advertising, but is not applicable if this contract was entered into by means of formal advertising.

(b) The Contractor agrees that the Comptroller General of the United States or any of his duly authorized representatives shall, until the expiration of 3 years after final payment under this contract or such lesser time specified in either Appendix M of the Armed Services Procurement Regulation or the Federal Procurement Regulations Part 1–20, as appropriate, have access to and the right to examine any directly pertinent books, documents, papers, and records of the Contractor involving transactions related to this contract.

(c) The Contractor further agrees to include in all his subcontracts hereunder a provision to the effect that the subcontractor agrees that the Comptroller General of the United States or any of his duly authorized representatives shall, until the expiration of 3 years after final payment under the subcontract or such lesser time specified in either Appendix M of the Armed Services Procurement Regulation or the Federal Procurement Regulations Part 1–20, as appropriate, have access to and the right to examine any directly pertinent books, documents, papers, and records of such subcontractor, involving transactions related to the subcontract. The term "subcontract" as used in this clause excludes (1) purchase orders not exceeding $10,000 and (2) subcontracts or purchase orders for public utility services at rates established for uniform applicability to the general public.

(d) The periods of access and examination described in (b) and (c), above, for records which relate to (1) appeals under the "Disputes" clause of this contract, (2) litigation or the settlement of claims arising out of the performance of this contract, or (3) costs and expenses of this contract as to which exception has been taken by the Comptroller General or any of his duly authorized representatives, shall continue until such appeals, litigation, claims, or exceptions have been disposed of.

11. DEFAULT

(a) The Government may, subject to the provisions of paragraph (c) below, by written notice of default to the Contractor, terminate the whole or any part of this contract in any one of the following circumstances:

(i) If the Contractor fails to make delivery of the supplies or to perform the services within the time specified herein or any extension thereof; or

(ii) If the Contractor fails to perform any of the other provisions of this contract, or so fails to make progress as to endanger performance of this contract in accordance with its terms, and in either of these two circumstances does not cure such failure within a period of 10 days (or such longer period as the Contracting Officer may authorize in writing) after receipt of notice from the Contracting Officer specifying such failure.

(b) In the event the Government terminates this contract in whole or in part as provided in paragraph (a) of this clause, the Government may procure, upon such terms and in such manner as the Contracting Officer may deem appropriate, supplies or services similar to those so terminated, and the Contractor shall be liable to the Government for any excess costs for such similar supplies or services: *Provided*, That the Contractor shall continue the performance of this contract to the extent not terminated under the provisions of this clause.

(c) Except with respect to defaults of subcontractors, the

Contractor shall not be liable for any excess costs if the failure to perform the contract arises out of causes beyond the control and without the fault or negligence of the Contractor. Such causes may include, but are not restricted to, acts of God or of the public enemy, acts of the Government in either its sovereign or contractual capacity, fires, floods, epidemics, quarantine restrictions, strikes, freight embargoes, and unusually severe weather; but in every case the failure to perform must be beyond the control and without the fault or negligence of the Contractor. If the failure to perform is caused by the default of a subcontractor, and if such default arises out of causes beyond the control of both the Contractor and subcontractor, and without the fault or negligence of either of them, the Contractor shall not be liable for any excess costs for failure to perform, unless the supplies or services to be furnished by the subcontractor were obtainable from other sources in sufficient time to permit the Contractor to meet the required delivery schedule.

(d) If this contract is terminated as provided in paragraph (a) of this clause, the Government, in addition to any other rights provided in this clause, may require the Contractor to transfer title and deliver to the Government, in the manner and to the extent directed by the Contracting Officer, (i) any completed supplies, and (ii) such partially completed supplies and materials, parts, tools, dies, jigs, fixtures, plans, drawings, information, and contract rights (hereinafter called "manufacturing materials") as the Contractor has specifically produced or specifically acquired for the performance of such part of this contract as has been terminated; and the Contractor shall, upon direction of the Contracting Officer, protect and preserve property in possession of the Contractor in which the Government has an interest. Payment for completed supplies delivered to and accepted by the Government shall be at the contract price. Payment for manufacturing materials delivered to and accepted by the Government and for the protection and preservation of property shall be in an amount agreed upon by the Contractor and Contracting Officer; failure to agree to such amount shall be a dispute concerning a question of fact within the meaning of the clause of this contract entitled "Disputes." The Government may withhold from amounts otherwise due the Contractor for such completed supplies or manufacturing materials such sum as the Contracting Officer determines to be necessary to protect the Government against loss because of outstanding liens or claims of former lien holders.

(e) If, after notice of termination of this contract under the provisions of this clause, it is determined for any reason that the Contractor was not in default under the provisions of this clause, or that the default was excusable under the provisions of this clause, the rights and obligations of the parties shall, if the contract contains a clause providing for termination for convenience of the Government, be the same as if the notice of termination had been issued pursuant to such clause. If, after notice of termination of this contract under the provisions of this clause, it is determined for any reason that the Contractor was not in default under the provisions of this clause, and if this contract does not contain a clause providing for termination for convenience of the Government, the contract shall be equitably adjusted to compensate for such termination and the contract modified accordingly; failure to agree to any such adjustment shall be a dispute concerning a question of fact within the meaning of the clause of this contract entitled "Disputes."

(f) The rights and remedies of the Government provided in this clause shall not be exclusive and are in addition to any other rights and remedies provided by law or under this contract.

(g) As used in paragraph (c) of this clause, the terms "subcontractor" and "subcontractors" mean subcontractor(s) at any tier.

12. DISPUTES

(a) Except as otherwise provided in this contract, any dispute concerning a question of fact arising under this contract which is not disposed of by agreement shall be decided by the Contracting Officer, who shall reduce his decision to writing and mail or otherwise furnish a copy thereof to the Contractor. The decision of the Contracting Officer shall be final and conclusive unless, within 30 days from the date of receipt of such copy, the Contractor mails or otherwise furnishes to the Contracting Officer a written appeal addressed to the Secretary. The decision of the Secretary or his duly authorized representative for the determination of such appeals shall be final and conclusive unless determined by a court of competent jurisdiction to have been fraudulent, or capricious, or arbitrary, or so grossly erroneous as necessarily to imply bad faith, or not supported by substantial evidence. In connection with any appeal proceeding under this clause, the Contractor shall be afforded an opportunity to be heard and to offer evidence in support of its appeal. Pending final decision of a dispute hereunder, the Contractor shall proceed diligently with the performance of the contract and in accordance with the Contracting Officer's decision.

(b) This "Disputes" clause does not preclude consideration of law questions in connection with decisions provided for in paragraph (a) above: *Provided*, That nothing in this contract shall be construed as making final the decision of any administrative official, representative, or board on a question of law.

13. NOTICE AND ASSISTANCE REGARDING PATENT AND COPYRIGHT INFRINGEMENT

The provisions of this clause shall be applicable only if the amount of this contract exceeds $10,000.

(a) The Contractor shall report to the Contracting Officer, promptly and in reasonable written detail, each notice or claim of patent or copyright infringement based on the performance of this contract of which the Contractor has knowledge.

(b) In the event of any claim or suit against the Government on account of any alleged patent or copyright infringement arising out of the performance of this contract or out of the use of any supplies furnished or work or services performed hereunder, the Contractor shall furnish to the Government, when requested by the Contracting Officer, all evidence and information in possession of the Contractor pertaining to such suit or claim. Such evidence and information shall be furnished at the expense of the Government except where the Contractor has agreed to indemnify the Government.

14. BUY AMERICAN ACT

(a) In acquiring end products, the Buy American Act (41 U.S. Code 10 a–d) provides that the Government give preference to domestic source end products. For the purpose of this clause:

(i) "Components" means those articles, materials, and supplies, which are directly incorporated in the end products;

(ii) "End products" means those articles, materials, and supplies, which are to be acquired under this contract for public use; and

(iii) A "domestic source end product" means (A) an unmanufactured end product which has been mined or produced in the United States and (B) an end product manufactured in the United States if the cost of the components thereof which are mined, produced, or manufactured in the United States exceeds 50 percent of the cost of all its components. For the purposes of this (a) (iii) (B), components of foreign origin of the same type or kind as the products referred to in (b) (ii) or (iii) of this clause shall be treated as components mined, produced, or manufactured in the United States.

(b) The Contractor agrees that there will be delivered under this contract only domestic source end products, except end products:

(i) Which are for use outside the United States;

(ii) Which the Government determines are not mined, produced, or manufactured in the United States in sufficient and reasonably available commercial quantities and of a satisfactory quality;

(iii) As to which the Secretary determines the domestic preference to be inconsistent with the public interest; or

(iv) As to which the Secretary determines the cost to the Government to be unreasonable.

(The foregoing requirements are administered in accordance with Executive Order No. 10582, dated December 17, 1954.)

15. CONVICT LABOR

In connection with the performance of work under this contract, the Contractor agrees not to employ any person undergoing sentence of imprisonment at hard labor except as provided by Public Law 89-176, September 10, 1965 (18 U.S.C. 4082(c)(2)) and Executive Order 11755, December 29, 1973.

16. CONTRACT WORK HOURS AND SAFETY STANDARDS ACT—OVERTIME COMPENSATION

This contract, to the extent that it is of a character specified in the Contract Work Hours and Safety Standards Act (40 U.S.C. 327-333), is subject to the following provisions and to all other applicable provisions and exceptions of such Act and the regulations of the Secretary of Labor thereunder.

(a) Overtime requirements. No Contractor or subcontractor contracting for any part of the contract work which may require or involve the employment of laborers, mechanics, apprentices, trainees, watchmen, and guards shall require or permit any laborer, mechanic, apprentice, trainee, watchman, or guard in any workweek in which he is employed on such work to work in excess of eight hours in any calendar day or in excess of forty hours in such workweek on work subject to the provisions of the Contract Work Hours and Safety Standards Act unless such laborer, mechanic, apprentice, trainee, watchman, or guard receives compensation at a rate not less than one and one-half times his basic rate of pay for all such hours worked in excess of eight hours in any calendar day or in excess of forty hours in such workweek, whichever is the greater number of overtime hours.

(b) Violation; liability for unpaid wages; liquidated damages. In the event of any violation of the provisions of paragraph (a), the Contractor and any subcontractor responsible therefor shall be liable to any affected employee for his unpaid wages. In addition, such Contractor and subcontractor shall be liable to the United States for liquidated damages. Such liquidated damages shall be computed with respect to each individual laborer, mechanic, apprentice, trainee, watchman, or guard employed in violation of the provisions of paragraph (a) in the sum of $10 for each calendar day on which such employee was required or permitted to be employed on such work in excess of eight hours or in excess of his standard workweek of forty hours without payment of the overtime wages required by paragraph (a).

(c) Withholding for unpaid wages and liquidated damages. The Contracting Officer may withhold from the Government Prime Contractor, from any moneys payable on account of work performed by the Contractor or subcontractor, such sums as may administratively be determined to be necessary to satisfy any liabilities of such Contractor or subcontractor for unpaid wages and liquidated damages as provided in the provisions of paragraph (b).

(d) Subcontracts. The Contractor shall insert paragraphs (a) through (d) of this clause in all subcontracts, and shall require their inclusion in all subcontracts of any tier.

(e) Records. The Contractor shall maintain payroll records containing the information specified in 29 CFR 516.2(a). Such records shall be preserved for three years from the completion of the contract.

17. WALSH-HEALEY PUBLIC CONTRACTS ACT

If this contract is for the manufacture or furnishing of materials, supplies, articles, or equipment in an amount which exceeds or may exceed $10,000 and is otherwise subject to the Walsh-Healey Public Contracts Act, as amended (41 U.S. Code 35-45), there are hereby incorporated by reference all representations and stipulations required by said Act and regulations issued thereunder by the Secretary of Labor, such representations and stipulations being subject to all applicable rulings and interpretations of the Secretary of Labor which are now or may hereafter be in effect.

18. EQUAL OPPORTUNITY

(The following clause is applicable unless this contract is exempt under the rules, regulations, and relevant orders of the Secretary of Labor (41 CFR, ch. 60).)

During the performance of this contract, the Contractor agrees as follows:

(a) The Contractor will not discriminate against any employee or applicant for employment because of race, color, religion, sex, or national origin. The Contractor will take affirmative action to ensure that applicants are employed, and that employees are treated during employment, without regard to their race, color, religion, sex, or national origin. Such action shall include, but not be limited to, the following: Employment, upgrading, demotion, or transfer; recruitment or recruitment advertising; layoff or termination; rates of pay or other forms of compensation; and selection for training, including apprenticeship. The Contractor agrees to post in conspicuous places, available to employees and applicants for employment, notices to be provided by the Contracting Officer setting forth the provisions of this Equal Opportunity clause.

(b) The Contractor will, in all solicitations or advertisements for employees placed by or on behalf of the Contractor, state that all qualified applicants will receive consideration for employment without regard to race, color, religion, sex, or national origin.

(c) The Contractor will send to each labor union or representative of workers with which he has a collective bargaining agreement or other contract or understanding, a notice, to be provided by the agency Contracting Officer, advising the labor union or workers' representative of the Contractor's commitments under this Equal Opportunity clause, and shall post copies of the notice in conspicuous places available to employees and applicants for employment.

(d) The Contractor will comply with all provisions of Executive Order No. 11246 of September 24, 1965, as amended by Executive Order No. 11375 of October 13, 1967, and of the rules, regulations, and relevant orders of the Secretary of Labor.

(e) The Contractor will furnish all information and reports required by Executive Order No. 11246 of September 24, 1965, as amended by Executive Order No. 11375 of October 13, 1967, and by the rules, regulations, and orders of the Secretary of Labor, or pursuant thereto, and will permit access to his books, records, and accounts by the contracting agency and the Secretary of Labor for purposes of investigation to ascertain compliance with such rules, regulations, and orders.

(f) In the event of the Contractor's noncompliance with the Equal Opportunity clause of this contract or with any of the said rules, regulations, or orders, this contract may be canceled, terminated, or suspended, in whole or in part, and the Contractor may be declared ineligible for further Government contracts in accordance with procedures authorized in Executive Order No. 11246 of September 24, 1965, as amended by Executive Order No. 11375 of October 13, 1967, and such other sanctions may be imposed and remedies invoked as provided in Executive Order No. 11246 of September 24, 1965, as amended by Executive Order No. 11375 of October 13, 1967, or by rule, regulation, or order of the Secretary of Labor, or as otherwise provided by law.

(g) The Contractor will include the provisions of paragraphs (a) through (g) in every subcontract or purchase order unless exempted by rules, regulations, or orders of the Secretary of Labor issued pursuant to section 204 of Executive Order No. 11246 of September 24, 1965, as amended by Executive Order No. 11375 of October 13, 1967, so that such provisions will be binding upon each subcontractor or vendor. The Contractor will take such action with respect to any subcontract or purchase order as the contracting agency may direct as a means of enforcing such provisions, including sanctions for noncompliance: *Provided, however,* That in the event the Contractor becomes involved in

or is threatened with, litigation with a subcontractor or vendor as a result of such direction by the contracting agency, the Contractor may request the United States to enter into such litigation to protect the interests of the United States.

19. OFFICIALS NOT TO BENEFIT

No member of or delegate to Congress, or resident Commissioner, shall be admitted to any share or part of this contract, or to any benefit that may arise therefrom; but this provision shall not be construed to extend to this contract if made with a corporation for its general benefit.

20. COVENANT AGAINST CONTINGENT FEES

The Contractor warrants that no person or selling agency has been employed or retained to solicit or secure this contract upon an agreement or understanding for a commission, percentage, brokerage, or contingent fee, excepting bona fide employees or bona fide established commercial or selling agencies maintained by the Contractor for the purpose of securing business. For breach or violation of this warranty the Government shall have the right to annul this contract without liability or in its discretion to deduct from the contract price or consideration, or otherwise recover, the full amount of such commission, percentage, brokerage, or contingent fee.

21. UTILIZATION OF SMALL BUSINESS CONCERNS

(a) It is the policy of the Government as declared by the Congress that a fair proportion of the purchases and contracts for supplies and services for the Government be placed with small business concerns.

(b) The Contractor agrees to accomplish the maximum amount of subcontracting to small business concerns that the Contractor finds to be consistent with the efficient performance of this contract.

22. UTILIZATION OF LABOR SURPLUS AREA CONCERNS

(a) It is the policy of the Government to award contracts to labor surplus area concerns that (1) have been certified by the Secretary of Labor (hereafter referred to as certified-eligible concerns with first or second preferences) regarding the employment of a proportionate number of disadvantaged individuals and have agreed to perform substantially (i) in or near sections of concentrated unemployment or underemployment or in persistent or substantial labor surplus areas or (ii) in other areas of the United States, respectively, or (2) are noncertified concerns which have agreed to perform substantially in persistent or substantial labor surplus areas, where this can be done consistent with the efficient performance of the contract and at prices no higher than are obtainable elsewhere. The Contractor agrees to use his best efforts to place his subcontracts in accordance with this policy.

(b) In complying with paragraph (a) of this clause and with paragraph (b) of the clause of this contract entitled "Utilization of Small Business Concerns" the Contractor in placing his subcontracts shall observe the following order of preference: (1) Certified-eligible concerns with a first preference which are also small business concerns; (2) other certified-eligible concerns with a first preference; (3) certified-eligible concerns with a second preference which are also small business concerns; (4) other certified-eligible concerns with a second preference; (5) persistent or substantial labor surplus area concerns which are also small business concerns; (6) other persistent or substantial labor surplus area concerns; and (7) small business concerns which are not labor surplus area concerns.

23. UTILIZATION OF MINORITY BUSINESS ENTERPRISES

(a) It is the policy of the Government that minority business enterprises shall have the maximum practicable opportunity to participate in the performance of Government contracts.

(b) The Contractor agrees to use his best efforts to carry out this policy in the award of his subcontracts to the fullest extent consistent with the efficient performance of this contract. As used in this contract, the term "minority business enterprise" means a business, at least 50 percent of which is owned by minority group members or, in case of publicly-owned businesses, at least 51 percent of the stock of which is owned by minority group members. For the purposes of this definition, minority group members are Negroes, Spanish-speaking American persons, American-Orientals, American-Indians, American-Eskimos, and American Aleuts. Contractors may rely on written representations by subcontractors regarding their status as minority business enterprises in lieu of an independent investigation.

24. PRICING OF ADJUSTMENTS

When costs are a factor in any determination of a contract price adjustment pursuant to the Changes clause or any other provision of this contract, such costs shall be in accordance with the contract cost principles and procedures in Part 1-15 of the Federal Procurement Regulations (41 CFR 1-15) or Section XV of the Armed Services Procurement Regulation, as applicable, which are in effect on the date of this contract.

25. PAYMENT OF INTEREST ON CONTRACTORS' CLAIMS

(a) If an appeal is filed by the Contractor from a final decision of the Contracting Officer under the Disputes clause of this contract, denying a claim arising under the contract, simple interest on the amount of the claim finally determined owed by the Government shall be payable to the Contractor. Such interest shall be at the rate determined by the Secretary of the Treasury pursuant to Public Law 92-41, 85 Stat. 97, from the date the Contractor furnishes to the Contracting Officer his written appeal under the Disputes clause of this contract, to the date of (1) a final judgment by a court of competent jurisdiction, or (2) mailing to the Contractor of a supplemental agreement for execution either confirming completed negotiations between the parties or carrying out a decision of a board of contract appeals.

(b) Notwithstanding (a), above, (1) interest shall be applic only from the date payment was due, if such date is later tha the filing of appeal, and (2) interest shall not be paid for an period of time that the Contracting Officer determines the Co tractor has unduly delayed in pursuing his remedies before board of contract appeals or a court of competent jurisdiction.

U. S. GOVERNMENT PRINTING OFFICE : 1976 O - 205-154

STANDARD FORM 32 (Rev. 4-