

# CONTRACT SETTLEMENT ACT OF 1944

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On July 1, 1944, the President approved the Contract Settlement Act of 1944, which is one of the most carefully considered pieces of legislation ever to have been enacted by the Congress. Congressional consideration of the measure began in June 1943. At that time the War Department requested enactment of a very short bill which would have given blanket authority to the Secretary of War to use departmental appropriations "in connection with the termination of War Department contracts, under such regulations as he may prescribe and without regard to any provision of law relating to the making, performance, amendment, or modification of contracts, for advance or partial payments to contractors with the War Department, or to subcontractors or suppliers directly or indirectly under such War Department contractors, or for loans or guaranties of loans to such contractors, subcontractors, or suppliers, or for the purchase of the rights of such contractors, subcontractors, or suppliers to such amounts certified by them to be due in connection with any such termination and upon such terms as the Secretary may permit by such regulations."

The War Department had first asked that the provisions of this bill be attached as a legislative rider to an Army appropriation bill. It is to the great credit of Congressman May, the Chairman of the House Military Affairs Committee, that he insisted on holding hearings<sup>1</sup> and bringing into the open the implications of this proposed Army rider.

Coinciding with increasing cut-backs early in 1943, the Senate Small Business Committee, of which I am Chairman, began to receive complaints from small businessmen whose contracts had been terminated and whose termination claims had remained unpaid. Following up these complaints, the newly created War Contracts Subcommittee of the Senate Military Affairs, under my Chairmanship, in the fall of 1943, held extensive hearings<sup>2</sup> for the purpose of finding out what was wrong with the termination procedure then used by the procurement agencies, and obtaining specific suggestions for contract termination legislation. The hear-

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<sup>1</sup> *Hearings before Committee on Military Affairs on H.R. 3022, 78th Cong., 1st Sess. (1943) Parts I and II.*

<sup>2</sup> *Hearings before a Subcommittee of the Committee on Military Affairs on S. 1268, S. 1280 and S. J. Res. 80, 78th Cong., 1st Sess. (1943) parts 1 to 16.*

ings brought out the imperative need for protecting subcontractors, particularly the smaller ones in case of contract terminations, by making available to them speedy and adequate interim financing and assisting them in the settlement of their termination claims.

Following the hearings frequent conferences were held with the Senate Committee on Post-War Economic Policy and Planning, industry groups and representatives of the several procurement agencies, and as a result thereof successive drafts of a contract termination bill were prepared by the War Contracts Subcommittee. Finally, on February 11, 1944, S. 1718 was introduced, jointly sponsored by Senators George and myself.

Shortly thereafter, Messrs. Baruch and Hancock submitted their report on War and Post-War Adjustment Policies. The recommendations contained in the report, with respect to the policies to be followed and the machinery to be established for the expeditious settlement of terminated war contracts, were substantially in accord with the provisions of the Murray-George bill, enactment of which was recommended by Messrs. Baruch and Hancock.

Following the introduction of S. 1718, the War Contracts Subcommittee submitted to the full Senate Military Affairs Committee an intermediate report in which it discussed the principal issues contained in S. 1718 and suggested improvements needed in the bill.<sup>3</sup> Shortly thereafter the Senate Special Committee on Post-War Economic Policy and Planning submitted a report to the War Contracts Subcommittee recommending the adoption of S. 1718 with some modifications.<sup>4</sup> Thereupon, at the beginning of May, the full Senate Military Affairs Committee reported S. 1718 to the Senate floor<sup>5</sup> and the Senate passed the measure substantially as reported by the Committee.

In the House of Representatives the bill was referred to the Judiciary Committee which, a month later, reported the bill favorably with an amendment.<sup>6</sup> The amendment conformed substantially to the recommendations made by the House Special Committee on Post-War Economic Policy and Planning.<sup>7</sup>

In the meantime the House Military Affairs Committee had reported favorably on a measure which placed the Comptroller General in charge of settling termination claims,<sup>8</sup> and the House Naval Affairs Committee on another bill which created an interdepartmental committee consisting of representatives of the principal procurement agencies and provided rigid cost standards for the settlement of termination claims.<sup>9</sup> Thus, the Rules Committee of the House of Representatives had before it three competing measures dealing with contract termination problems.

<sup>3</sup> REPORT OF THE WAR CONTRACTS SUBCOMMITTEE TO THE COMMITTEE ON MILITARY AFFAIRS, SUBCOMMITTEE PRINT No. 2, 78th Cong., 2d Sess. (1944).

<sup>4</sup> SEN. REP., No. 539, 78th Cong., 2d Sess. (1944) part 5.

<sup>5</sup> SEN. REP., No. 836, 78th Cong., 2d Sess. (1944).

<sup>6</sup> H.R. REP., No. 1590, 78th Cong., 2d Sess. (1944).

<sup>7</sup> H.R. REP., No. 1443, 78th Cong., 2d Sess. (1944).

<sup>8</sup> H.R. REP., No. 1268, 78th Cong., 2d Sess. (1944).

<sup>9</sup> H.R. REP., No. 1355, 78th Cong., 2d Sess. (1944).

The Committee voted a rule in favor of S. 1718 as reported by the Judiciary Committee, and the measure was passed shortly thereafter by the House. In conference the House and Senate conferees eliminated all differences between the Senate and the House versions of S. 1718,<sup>10</sup> and approximately one year after consideration of termination legislation had first begun, the Senate and the House agreed to the conference report.

#### PRINCIPLES OF THE ACT

The Act is based on two fundamental principles which govern substantially all of its provisions.

(1) In order to avoid mass business failures and widespread unemployment, termination claims of all war contractors—prime contractors and subcontractors alike—must be settled and paid with the greatest possible speed, and

(2) The Government, in settling and paying such claims, must be carefully protected against waste and fraud.

The need for speed in connection with contract termination settlements is too obvious to merit any discussion. The absence of speedy settlement machinery was the principal reason for the enactment of contract termination legislation. The need for protecting the Government against the waste of funds and fraud is equally clear, and the several ways in which the Act attempts to protect the Government are summarized below.

#### OFFICE OF DIRECTOR OF CONTRACT SETTLEMENT

The Act establishes the Office of Contract Settlement, headed by a Director. The Office is visualized as a policy-making and coordinating, and not as an operating agency. The Director has power, by general orders or regulations, to prescribe policies and procedures to be followed by all Government agencies exercising authority and discretion under the Act.<sup>11</sup> In addition the Director is called upon to investigate termination settlement and interim financing activities of the contracting agencies;<sup>12</sup> to promote the training of personnel for termination settlement and interim financing by contracting agencies, war contractors and financing institutions; to collaborate with the Smaller War Plants Corporation in protecting the interests of smaller war contractors in obtaining fair and expeditious settlements and financing; to decentralize the administration of termination settlements and interim financing; and to consult with war contractors through advisory committees or such other methods as he deems appropriate.<sup>13</sup>

In order to coordinate fully the activities of the various Government agencies under the Act, a Contract Settlement Advisory Board is created, with which the Director shall advise and consult. The Board consists of representatives of the principal procurement agencies, the War Production Board, the Smaller War Plants Corporation, the Reconstruction Finance Corporation and the Attorney General.<sup>14</sup>

<sup>10</sup> H.R. REP., No. 1708, 78th Cong., 2d Sess. (1944).

<sup>11</sup> CONTRACT SETTLEMENT ACT OF 1944, sec. 4; 12 U. S. LAW WEEK 71 (June 27, 1944). (In footnotes that follow, citations of sections refer to this Act.)

<sup>12</sup> Sec. 18(d).

<sup>13</sup> Sec. 21.

<sup>14</sup> Sec. 5.

## BASIS FOR SETTLEMENT OF TERMINATION CLAIMS

The Act states that "it is the policy of the Government, and it shall be the responsibility of the contracting agencies and the Director, to provide war contractors with speedy and fair compensation for the termination of any war contract. . . ." It further provides that the compensation payable to subcontractors shall be based on the same principles as compensation for the termination of prime contracts.<sup>15</sup>

Termination claims may be settled either by agreement or, in case an agreement fails to be reached, by determination on the part of the contracting agency.<sup>16</sup> However, in keeping with its objectives, the Act provides that termination claims shall be settled by agreement to the maximum extent feasible.<sup>17</sup> Wherever it may facilitate settlements, the contracting agencies have power to deal directly with subcontractors<sup>18</sup> or settle all claims of a contractor on an overall basis.<sup>19</sup> A Subcommittee on Overall Company Settlements of the Joint Contract Termination Board has made a careful study of the feasibility of this method of settling termination claims, and it is hoped that in view of the favorable conclusions reached by the subcommittee, this method will be used extensively in an effort to speed the settlement process.

One of the major differences between the Senate and House versions of S. 1718 revolved around the question of cost principles. S. 1718 as passed by the Senate, did not contain detailed provisions regarding cost principles to be followed by the contracting agencies either in negotiating settlements or in determining the amount due on a termination claim where an agreement fails to be reached. S. 1718 as passed by the House, on the other hand, upon recommendation of the House Judiciary Committee,<sup>20</sup> included a long list of cost principles derived largely from the Baruch-Hancock uniform termination article. In conference between the House and the Senate those cost principles were replaced by a broader and more general set of principles to be found in Section 6(d).

The Act recognizes that in spite of the broad and general character of these principles, considerable latitude must be given to the Director and to the contracting agencies, in order to obtain prompt and equitable termination settlements. Therefore, the Act provides that "where the small size of claims or the nature of production or other factors make it impracticable to apply the [cost] principles . . . to any class of settlements, . . . the contracting agencies may establish alternative methods and standards for determining fair compensation for that class of termination claims."<sup>21</sup>

While the cost principles are designed primarily as a guide for the settlement of termination claims which are not settled by agreement, the Act provides that,

<sup>15</sup> Sec. 6(a).

<sup>16</sup> Sec. 6(c).

<sup>18</sup> Sec. 7(d).

<sup>20</sup> H.R. REP., No. 1590, 78th Cong., 2d Sess. (1944) 31 ff.

<sup>21</sup> Sec. 6(d).

<sup>17</sup> Sec. 6(e).

<sup>19</sup> Sec. 7(c).

"to the extent that he deems it practicable to do so without impeding expeditious settlements, the Director shall require the contracting agencies to take into account [those cost principles] . . . in establishing methods and standards for determining fair compensation in the settlement of termination claims by agreement."<sup>22</sup> With this exception, the Act leaves broad discretion to the Director and the contracting agencies in establishing methods and standards for determining fair compensation. It provides that each contracting agency, subject to the rules and regulations of the Director, shall establish methods and standards suitable to the conditions of various war contractors, for determining fair compensation for the termination of war contracts. The methods and standards may be based on . . . "actual, standard, average, or estimated costs, or . . . a percentage of the contract price based on the estimated percentage of completion of work under the terminated contract, or on any other equitable basis. . . ." To the extent that the methods and standards require accounting, they shall be adapted, so far as practicable, to the accounting systems used by war contractors where such systems are consistent with recognized commercial accounting practices.<sup>23</sup>

Settlements made by agreement are final and conclusive except (1) to the extent otherwise agreed in the settlement; (2) for fraud; (3) upon renegotiation to eliminate excessive profits under the Renegotiation Act; or (4) by mutual agreement before or after payment. The House added the additional requirement that no settlement agreement involving payment to a war contractor of an amount in excess of \$50,000 shall become binding upon the Government until the agreement has been approved by a settlement review board of three or more members to be established on a decentralized basis in the offices of the contracting agencies. The Conference Committee qualified this requirement by adding a provision to the effect that the failure of a settlement review board to act upon any settlement within 30 days after its submission to the board shall operate as approval by the board. The sole function of the settlement review boards is to determine the overall reasonableness of proposed settlement agreements from the point of view of protecting the interests of the Government.<sup>24</sup>

#### APPEALS

Where a war contractor fails to reach an agreement with a contracting agency with respect to his termination claim, he may demand a determination by the contracting agency as to the amount due him on such claim. The Act provides that the contracting agency shall make this determination and deliver its findings to the war contractor within 90 days after receipt by the agency of the war contractor's demand therefor.

If the war contractor is aggrieved by the determination of the contracting agency and if the contracting agency provides a procedure within the agency for protest against such findings, he may within 30 days after delivery of the findings file a

<sup>22</sup> Sec. 6(e).

<sup>23</sup> Sec. 6(b). For comments upon propriety of "recognized commercial accounting practices," see Peacock, *Accounting Problems in Terminations*, *supra* pp. 598-602. [Ed.]

<sup>24</sup> Sec. 6(c).

protest.<sup>25</sup> If upon protest the contracting agency fails to modify its determination and findings in a satisfactory manner, the war contractor may appeal within 90 days to the Appeal Board to be established by the Director,<sup>26</sup> or may bring suit against the United States in the Court of Claims or in a United States District Court if the amount of the claim is below \$10,000.

S. 1718 as passed by the Senate gave war contractors the right to elect whether to appeal to the Court of Claims (or if the amount was below \$10,000, to a United States District Court) or to an Appeal Board to be established in accordance with the legislation, but when a war contractor had initiated proceedings by one method he was precluded from initiating proceedings on the same claim by any other method.<sup>27</sup> The House changed this provision by allowing war contractors who feel themselves aggrieved by a decision of the Appeal Board to bring suit as if no appeal had been taken under the Act to the Appeal Board. The Senate conferees agreed to the House amendment, so that under the Act a war contractor who is aggrieved by a decision of the Appeal Board may bring suit in the Court of Claims or in a United States District Court as if he had not appealed to the Appeal Board.<sup>28</sup>

Instead of appealing to the Court of Claims or the Appeal Board, a war contractor may, where the contracting agency agrees to arbitration, submit the dispute to arbitration, and any arbitration award is to be final and conclusive like an agreement between the contracting agency and the war contractor.<sup>29</sup>

Whenever a dispute exists between a war contractor and a subcontractor regarding any termination claim, they may agree to submit their dispute to the Appeal Board or to a contracting agency for mediation or arbitration whenever such mediation or arbitration is authorized by the agency or required by the Director.<sup>30</sup>

For the purpose of expediting the adjudication of termination claims, the Court of Claims is authorized to appoint not more than ten auditors and not more than twenty commissioners in addition to those now appointed.<sup>31</sup> In order to enable the Court of Claims to adjudicate all divergent interests in a single proceeding, the Court of Claims upon motion of either party or on its own motion, may summon any person to appear as a party in a suit pending in the Court of Claims to assert and defend their interest in such suit.<sup>32</sup>

<sup>25</sup>The Director may require that aggrieved war contractors resort to the protest procedure before appealing to the Appeal Board or bringing suit in the Court of Claims, but failure of the contracting agency to act on any such required protest within 30 days operates as a refusal by the agency to modify its findings.

<sup>26</sup>Sec. 13(d). The members of the Appeal Board are appointed by the Director for a term not to exceed two years and are to receive compensation not to exceed \$10,000 per annum. The members of the Appeal Board shall be qualified and experienced attorneys, engineers, accountants or persons possessing sufficient business experience or professional skill. Panels of one member may hear any appeal where the amount in controversy is \$25,000 or less, or if the amount is in excess of \$25,000, where the war contractor fails to demand a panel of three members.

<sup>27</sup>Sec. 13(c), (4) of S. 1718 as passed by the Senate.

<sup>28</sup>Sec. 13(d) (2).

<sup>29</sup>Sec. 13(e).

<sup>31</sup>Sec. 14(a).

<sup>30</sup>Sec. 13(f).

<sup>32</sup>Sec. 14(b).

## INTERIM FINANCING

Since some delay in arriving at settlements will be unavoidable, it is vital to war contractors whose contracts have been terminated, and particularly to smaller war contractors, that interim financing be made available so that such war contractors have sufficient working capital to allow them to engage in other war production or to resume civilian production.

The Act states that it is the policy of the Government, and makes it the responsibility of the contracting agencies and the Director, to provide prime contractors and subcontractors, pending the settlement of their termination claims, with adequate interim financing within 30 days after proper application therefor.<sup>33</sup> The contracting agencies are authorized to utilize a wide variety of financing methods. They are directed to make available interim financing to the greatest extent practicable through loans and discounts in advance of actual terminations. It is hoped that this method will lighten the interim financing burden of the procurement agencies in case of wholesale terminations, and will enable war contractors to plan for the reconversion period, knowing that upon termination they will have available a definite amount of working capital. It is contemplated that a large scale termination loan program, utilizing the facilities of private and public banks, will be established immediately. To the extent that loans do not take care of the needs of war contractors, the Act establishes standards for the making of advance or partial payments upon termination by the contracting agencies prior to final settlement.<sup>34</sup>

REMOVAL AND STORAGE OF TERMINATION INVENTORIES AND  
GOVERNMENT-OWNED MACHINERY

Just as important for expeditious reconversion of American industry as prompt interim financing and settlements is the early removal from war plants of all Government-owned machinery and termination inventory not to be retained or sold by the war contractor. The Act makes it the policy of the Government, upon termination of any war contract, to assure such expeditious removal. Any war contractor may submit to the contracting agency concerned statements showing the machinery and those parts of his termination inventory which he desires to have removed by the Government. If within 60 days after his submission of such statement the Government fails to arrange for the storage of the machinery or termination inventory by the war contractor or fails to remove such machinery or termination inventory not stored by the war contractor, he may remove some or all of such machinery and termination inventory at the risk and expense of the Government.<sup>35</sup>

## PROTECTION OF SMALLER WAR CONTRACTORS

While it is far from true that all subcontractors are small business concerns, most small business concerns engaged in the war effort are subcontractors. Those smaller concerns are particularly in need of protection when it comes to the termination of

<sup>33</sup> Sec. 8(a).

<sup>34</sup> Sec. 8(b).

<sup>35</sup> Sec. 12.

their war contracts, and the Act contains several provisions which are aimed at supplementing the general provisions of the Act which apply to prime contractors and subcontractors alike.

In order to make sure that small subcontractors are well prepared in advance of contract terminations and receive fair and equitable treatment from their prime contractors and intermediate subcontractors, the Act directs the Smaller War Plants Corporation to disseminate information among and to assist such concerns with respect to interim financing, termination settlements, removal and storage of termination inventories, and makes it the duty of the Director to collaborate with the Smaller War Plants Corporation towards that end.<sup>36</sup>

Since testimony before the War Contracts Subcommittee had revealed the fact that many subcontracts do not contain termination clauses providing for the payment of fair compensation to the subcontractor in case of termination, the Act provides that the contracting agencies, either before or after termination, shall authorize, approve or ratify the amendment of any war contract by the parties thereto, to provide for fair compensation in case of its termination.<sup>37</sup>

While prime contractors do not have any credit risk in connection with their termination claims, a subcontractor who has been dealing with a financially weak war contractor stands to lose money upon termination if the war contractor against whom he has a termination claim goes bankrupt. The Act therefore attempts, to the largest extent practicable, to eliminate this additional risk and provides that "whenever any contracting agency is satisfied of the inability of a war contractor to meet his obligations, it shall exercise supervision or control over payments to the war contractor on account of termination claims of subcontractors of such war contractor to such extent and in such manner as it deems necessary or desirable for the purpose of assuring the receipt of the benefit of such payments by the subcontractors."<sup>38</sup> Where, in spite of the exercise of such control or supervision, a subcontractor fails to receive fair compensation for the termination of a war contract, and where a contracting agency determines that "in the circumstances of a particular case equity and good conscience require fair compensation for the termination of a war contract to be paid to a subcontractor who has been deprived of and cannot otherwise reasonably secure such fair compensation, the contracting agency concerned may pay such compensation to him although such compensation already has been included and paid as part of a settlement with another war contractor."<sup>39</sup>

#### PROTECTION OF THE GOVERNMENT

So far the discussion has revolved around the rights of war contractors under the Contract Settlement Act, all of which stem from the first principle of the Act, that war contractors must be afforded speedy and fair termination settlements. The second guiding principle of the Act is concerned with the protection of the Govern-

<sup>36</sup> Sec. 20(g) and 21(b).

<sup>38</sup> Sec. 7(b).

<sup>37</sup> Sec. 6(g).

<sup>39</sup> Sec. 7(f).



ment against waste and fraud in making interim financing and settlements. The Act attempts to protect the Government in the following manner:

(1) The full responsibility for settling terminated war contracts and making interim financing available has been placed squarely upon the shoulders of the contracting agencies who are familiar with the contracts and who have adequate personnel to bring about fair settlements.

(2) The Director of Contract Settlement is established as an independent civilian agency with policy-making and supervisory powers over the contracting agencies in connection with contract settlement and interim financing activities. It is one of the functions of the Director to insist on settlement methods and procedures which will protect the Government against waste of funds and fraud.

(3) The General Accounting Office, as the investigatory arm of the Congress, is authorized to investigate settlements completed by the contracting agencies for the purpose of reporting to Congress whether the settlement methods and procedures employed by the contracting agencies are of a kind and type designed to assure expeditious and fair settlements, and whether such methods and procedures adequately protect the interests of the Government. The Comptroller General is directed to make recommendations to the contracting agencies concerned and to the Congress if he shall find that the settlement methods and procedures fail to meet the standards of expeditiousness and fairness. Furthermore, the Comptroller General is to determine whether settlement payments are made in accordance with the settlements and whether settlements are induced by fraud. The Act provides that whenever the Comptroller General is convinced that any settlement was induced by fraud he shall so certify, together with all the facts related thereto, to the Department of Justice, the Director and the contracting agency concerned. Upon receipt of such certificate the Department of Justice is called upon to make an investigation to determine whether the settlement was induced by fraud and the contracting agency may withhold payment until the Department of Justice notifies the agency that in its opinion the settlement was not induced by fraud.<sup>40</sup>

(4) In order to facilitate investigation of waste and prosecution of fraud, the Act requires the preservation of records relating to contract termination and disposal of termination inventories for five years after the final settlement or five years after the termination of hostilities, whichever period is longer. The Act provides severe penalties for the destruction of records and the perpetration of fraud.<sup>41</sup>

(5) Finally, the Congress through the appropriate committees of the Senate and the House will maintain continuous surveillance over the operations of the Government agencies under the proposed legislation. The Congress will appraise the reports submitted by the Director and the Comptroller General, and, if necessary, will make suitable changes in the law in order to make absolutely sure that the dual purpose of this legislation to settle termination claims speedily and to protect the Government's interests, is achieved.<sup>42</sup>

<sup>40</sup> Sec. 16.

<sup>41</sup> Sec. 19.

<sup>42</sup> Sec. 2

This last concept of Congressional surveillance is a new one. It makes it clear that the Congress has not discharged its responsibility to the people by enacting the Contract Settlement Act of 1944, and by confirming the President's choice for the position of Director. It places the continued responsibility on the Congress to see to it that the policies laid down in this legislation are carried out by the executive branch and that appropriate amendments are enacted if the Act should prove at a later point to be insufficient in some respects.

The concept of continuous surveillance by Congress is an important one for the future relationship between the legislative and executive branches of our Government. Because of the complexity of modern economic life and the need for experimentation in coping with our economic problems, Congress will be compelled with increasing frequency to enact legislation setting forth basic policies and giving the executive branch adequate discretion and authority to carry out these policies. Continuous surveillance by Congress of executive actions under such grant of authority will help to keep Congress informed of the need for further legislation and to check actions by the executive branch in disregard of the objectives set forth by Congress in such legislation.

#### CONTRACT TERMINATION LEGISLATION AND OTHER RECONVERSION LEGISLATION

Some people have seen fit to over-emphasize the importance of contract termination legislation in the reconversion picture. While adequate contract settlement machinery and policies are important for the expeditious readjustment of the American economy from a wartime basis to a peacetime basis, other problems are of equal if not greater importance and will have to be dealt with by the Congress at the earliest possible moment. Among those are adequate unemployment compensation; the disposal of surplus property; the creation of a central agency with adequate powers to coordinate the activities of all Government agencies concerned with the reconversion process; specific policies with respect to manpower demobilization and reemployment, cut-backs and resumption of civilian production in industry; provisions for housing and public works; and a post-war taxation program. Those are the problems with which Congress will have to wrestle and Congress will not have discharged its responsibilities to the American people until a complete legislative program for the reconversion period has been enacted.