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RICHARD C. JOHNSON*

Among those hardest hit by the drastic inflation surge in the United States are government contractors with long-term fixed price contracts for construction or for major systems such as Naval ships, those with multi-year contracts for supplies or services that may extend for as many as five years,¹ and those with contracts containing option clauses for as much as fifty percent of the basic quantity at no increase in unit price.² One example of 1973-74 inflationary price increases experienced by a major Navy shipbuilder was brought out in recent hearings before a subcommittee of the House Armed Services Committee: wire rope, 76%; gasoline, 40%; diesel fuel, 113%; bunker C fuel, 153%; steel shot, 97%; and copper cable, 71%.³ Clearly, this type of drastic cost increase, while not unique to contractors who deal with the government, is a cause for major concern among contractors and government officials alike.

The inflation crunch is especially severe for government contractors, however, because they have traditionally faced a buyer-dominated market in which contract terms and conditions are offered on a take it or leave it basis. Once into the period of performance, government contractors consequently confront a formidable bureaucracy characterized by limited flexibility in responding to the radically changed circumstances presented by such developments as double-digit inflation. Unlike his civilian counterpart, the government contracting officer has little or no power to adjust contract prices when equity or practical considerations require,⁴ and his authority in general is limited by a bewildering array of regulatory and decisional law.⁵

¹ See, e.g., 32 C.F.R. § 1.322-1(a) (1974).
² See, e.g., 32 C.F.R. § 1.1504(a) (1974). The percentage may be increased “when unusual circumstances exist.”
⁴ See generally R. NASH & J. CIRINIC, FEDERAL PROCUREMENT LAW, 201-06, 974-76 (2d ed. 1969).
⁵ Id. at 77-85.
Faced with the severe economic losses by continued dealings with the government, companies fortunate enough to find alternate purchasers for their goods and services may turn away from government contracting altogether. In the long run, however, any substantial exodus of firms from government procurement would seriously damage the national interest and ought not to be accepted by responsible federal policy makers. Moreover, a very large part of the problem exists in the present and cannot be avoided. Companies that accepted relatively long term fixed-price contracts between 1971 and 1973 are now confronted by tremendous losses created by the energy crisis and double-digit inflation. Should federal officials fail to respond effectively, business failures and resulting unemployment will inevitably curtail the flow of necessary goods and services required to support vital government programs. Yet the government's response itself can be inflationary and government contractors cannot reasonably expect relief to be granted wholly without regard to the nation's fundamental anti-inflationary policies.

One of the limited safety valves which might protect government contractors against the ravages of double-digit inflation is the availability of 'extraordinary contractual relief' under Public Law 85-804. Although it can be administered to provide some relief in its present form, it may need to be adjusted to meet the present crisis.

I. THE STATUTORY AND ADMINISTRATIVE FRAMEWORK

Public Law 85-804, enacted in 1958, empowers the President "to enter into contracts or into amendments or modifications of contracts . . . without regard to other provisions of law relating to the making, performance, amendment, or modification of contracts, whenever he deems that such action would facilitate the national defense." Thus,

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6 For example, in the Hearings Before Subcommittee No. 3 of the House Armed Services Committee on the "Overall Shipyard Situation," August 6, 1974 (unpublished transcript on file at Washington & Lee Law Review), at 863, the following statement was made by Mr. John P. Diesel, President of Newport News Shipbuilding and Drydock Company:

... on existing contracts, we are faced with the problem of an inflationary impact not foreseen by either the Navy or the shipbuilders at the time of contracting and parenthetically, I might add, not foreseen by either Government or private economists. A mutually acceptable solution to this dilemma on existing contracts must be reached.


the statute in its broadest sense removes the prohibition against making amendments to contracts without consideration, and vests in the executive branch a wide-ranging discretion to remedy inequities in its contractual dealings, such as those created by the current surge of inflation. The authority of the Act was initially granted by executive order to the Department of Defense, and was extended later to a number of other departments and agencies. Implementation of the Act is found in the Armed Services Procurement Regulations, the Federal Procurement Regulations, and the separate regulations of AEC and NASA.

The regulations provide generally that a request for extraordinary contractual relief such as an increase in contract price may be filed with the cognizant contracting officer. However, review and final disposition by the agency are confined to a Contract Adjustment Board or other officials at the secretarial or equivalent level.

II. RELIEF FOR “ESSENTIALITY TO THE NATIONAL DEFENSE” IN INFLATION CASES

Although the statute is couched in extraordinarily sweeping terms, the implementing regulations have purported to limit its application by delineating specific circumstances under which relief

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Cerin, Federal Procurement Law, 976-78 (2d ed. 1969). The 1973 amendment places a $25,000,000 limitation upon any obligation under the statute unless the respective Armed Services Committee shall first have been notified and neither House has adopted within 60 days a resolution disapproving such obligation. For a general discussion of P.L. 85-804 and its predecessors, see Jansen, Public Law 85-804 and Extraordinary Contractual Relief, 55 Geo. L.J. 959-1017 (1967).


13 32 C.F.R. § 17.000 et seq. (1974).
14 41 C.F.R. § 17.000 et seq. (1974).
16 41 C.F.R. § 18-17.000 et seq. (1974).
17 This discussion refers to the Armed Services Procurement Regulation which was closely followed in the later development of regulations applicable to the other agencies. Exec. Order No. 10789, Nov. 15, 1958, as amended, provides in paragraph 22 that “[S]uch regulations of other agencies shall, to the extent practicable, be uniform with the regulations prescribed or approved by the Secretary of Defense . . . .” Exec. Order No. 10789, 3 C.F.R. 80-85 (1974). Any significant differences will be noted.
19 E.g., 32 C.F.R. § 17.202 (1974). The Board for each Military Department consists of a Chairman and from two to six other members.
may be granted. The first such area directly relevant to drastic and unforeseen inflation is that of "essentiality" to the national defense:

Where an actual or threatened loss under a defense contract, however caused, will impair the productive ability of a contractor whose continued performance on any defense contracts or whose continued operation as a source of supply is found to be essential to the national defense, the contract may be adjusted but only to the extent necessary to avoid such impairment to the contractor's productive ability. 17

The words "actual or threatened loss . . . however caused" remove any possible requirement of causation that might otherwise exist in inflation cases. Indeed, far from having to establish any particular excusable cause for their losses, contractors have been granted relief under this provision when their losses were caused by "unrelated operations" 18 or even a "lack of competent management." 19 Moreover, the words "impair the productive ability" and "essential to the national defense" are not self-limiting and can be broadly construed to include almost any defense-related activity that is experiencing severe inflation losses under contracts with the government. However, the full potential of this regulatory language has not been utilized to date in the decisions of the Contract Adjustment Boards.

A. Impairment of Productive Ability

For a contractor to establish impairment of productive ability, the Contract Adjustment Boards have consistently required a showing of close to actual insolvency and imminent production stoppage. The fact that a tremendous loss may be incurred on a particular contract or contracts has generally had no bearing provided the contractor has the resources with which to continue. Thus, if the contractor fails to show either insolvency or imminent production stoppage, relief will ordinarily be denied.

Circumstances that have been held to meet the Board-developed insolvency requirement include deficit working capital and inability

to discharge current liabilities,\textsuperscript{20} continuous cash shortages,\textsuperscript{21} inability to obtain commercial financing of any kind,\textsuperscript{22} actual or threatened vendor action to halt deliveries of subcontracted parts and supplies,\textsuperscript{23} and imminent bankruptcy.\textsuperscript{24} Conversely, relief has been denied even where a contractor has demonstrated losses of $4.5 million in two years and a decrease in shareholders’ equity from $11.2 million to $6.5 million. Because the contractor’s total assets and current assets increased, the Board found “no evidence that the solvency of the Contractor . . . is presently endangered by the losses.”\textsuperscript{25} In another case, the NASA Board found that “although the Contractor has demonstrated that it has suffered a loss on the contract involved in this request for relief, the profit and loss data and statement of assets and liabilities submitted do not reveal symptoms of insolvency or other indication that the Contractor’s continued operation is endangered.”\textsuperscript{26}

Where the insolvency standard has been met, relief has readily been granted for inflation cases. In \textit{Servrite International, Ltd.},\textsuperscript{27} a 1973 Navy Contract Adjustment Board case, the impairment was created by “unanticipated cost increases” including “unforeseen [Italian] increased wage rates and social contributions due to run away inflation” and “higher than anticipated utility rates established by local Italian authorities as a result of unstable economic conditions in the country.”\textsuperscript{28} Relief was also granted in \textit{Hol-Gar Manufacturing Corp.},\textsuperscript{29} a fixed-price contract for generator sets. The contract was awarded in June 1973, and 812 sets had been ordered as of February 1974. During this period, production costs increased by approximately 20\%, in part due to inflation\textsuperscript{30} and in part due allegedly to defective Government drawings. In \textit{Allegheny Metal Stamping Co.},\textsuperscript{31} fixed-price contracts were awarded in December 1972, and June 1973,

\textsuperscript{20} Memcor, Inc., ACAB 1080 (12 Sept. 1966), 2 ECR ¶ 17.
\textsuperscript{22} Doughboy Indus., Inc., ACAB 1089 (23 Feb. 1968), 2 ECR ¶ 54.
\textsuperscript{24} Cleveland Pneumatic Tool Co., AFCAB 206 (18 Jan. 1971), 2 ECR ¶ 120, at 3.
\textsuperscript{26} NCAB (5 Nov. 1973), 2 ECR ¶ 201.
\textsuperscript{27} 2 ECR ¶ 201, at 2. The percentages of the cost increases over original projections are not specified in the decision.
\textsuperscript{28} AFCAB 221 (7 Feb. 1974) (unpublished decision).
\textsuperscript{29} Id. at 2. The contracting officer estimated a price increase on repurchase from another source of approximately 20\% due solely to the “inflationary trend of prices generally.”
\textsuperscript{30} ACAB 1154 (14 Mar. 1974), 3 ECR ¶ 5.
for 5.56mm cartridge clips. Thereafter, the price of steel rose 23% and the price of copper 90% with the result that the contractor could not continue production. In this instance the Board not only granted relief of $129,257 but also authorized the contracting officer to include escalation provisions in the contracts to provide both for future increases in the costs of the copper and steel and for the satisfactory completion of the contract.\footnote{See also Libby Welding Co., ACAB 1163 (4 Sept. 1974), 3 ECR \textsuperscript{33} 23; Kisco Co., ACAB 1167 (10 Oct. 1974), 3 ECR \textsuperscript{33} 24.}

A narrow exception to the strictures of the insolvency rule may exist, however, if the contractor can show three things: (1) that he has suffered a severe loss on current contracts; (2) that he is an essential or sole source of supply for items as to which future requirements are firm; and (3) that although not presently threatened with insolvency, he will be, or may be, unable to undertake performance of those future contracts. The only case meeting these requirements is \textit{Amron Corp.}, which was decided by the Army Contract Adjustment Board.\footnote{ACAB 1155 (1 May 1974), 3 ECR \textsuperscript{33} 8. For some reason, the same decision is reported as ACAB 1155A (7 June 1974), 3 ECR \textsuperscript{33} 12.}

The contractor was a designated Mobilization Base supplier for nine defense items. Of these items, Amron’s production constituted a significant part of the total national capacity for six items for which it was the single active source; for the other three it represented 100% of the total U.S. base capacity.\footnote{3 ECR \textsuperscript{33} 23; Kisco Co., ACAB 1167 (10 Oct. 1974), 3 ECR \textsuperscript{33} 24.} A contract was awarded in January 1973 for 20mm brass cartridge cases at a fixed price with no escalation, and with a Government option to increase the quantity by 50%.\footnote{Id. \textsuperscript{33} 8, at 1.} Between January and October, 1973, the price of brass increased about 48%.\footnote{Id. \textsuperscript{33} 8, at 2.}

For these reasons, and despite the absence of a showing that Amron faced any prospect of insolvency during production on its current contract, the Board found that “the threatened loss . . . will seriously impair Amron’s ability to continue as a source of supply,” and granted relief calculated as the amount “Amron requires to maintain its productive ability as a source of supply.”\footnote{Id. \textsuperscript{33} 8, at 3.}

It would be unjustified to view the \textit{Amron} case alone as a clear signal that the insolvency rule is about to be relaxed. Amron had sole-source status and the Army Board could do little else but grant some form of relief. Thus, under the Boards’ current reasoning, with the \textit{Amron} exception noted, inflation cases based on “impairment” must

\footnote{\textit{Id.} \textsuperscript{33} 8, at 3-4.}
still pass the stringent brink-of-insolvency test. That test, however, is unnecessarily restrictive. Severe financial losses created by runaway inflation may seriously impair a contractor's productive ability without bringing him to the point of insolvency. A contractor may, for example, be unable to make needed capital investments in defense-related equipment or facilities, thus making him less active as a competitor in the future. Moreover, once a contractor reaches the brink of insolvency, it is often too late to provide effective relief to him on other than a stop-gap basis, and his long-term availability as a source of supply and a competitor for government business may already be lost.

Most significantly, the strictures of the impairment rule as interpreted by the Boards do not reflect the realities of the current inflation crunch, since massive inflation losses may strike both a well-funded business and the marginal producer alike. However, policy changes may be in the wind at the highest level of at least the Department of Defense. A June 12, 1974, policy memorandum of the Assistant Secretary of Defense (Installations & Logistics) to the Assistant Service Secretaries (I&L) calls attention to economic problems attributable to energy-related shortages and cites Public Law 85-804 as one method of coping with the resulting inequities. The memorandum states in pertinent part:

[W]hen actual or threatened loss under a Defense contract will impair the productive ability of the contractor whose continued performance is essential to the national defense, consideration can and has been given to requests for relief under the provisions of Public Law 85-804, on a case by case basis.

. . . . .

It is not our intent or desire to cause well managed contractors large or small, to suffer loss. Neither is it our intent or desire to add fuel to the fire of spiraling prices by being willing to pay any amount asked. But, we should continue to take positive action for easing the gross uncertainties in price fluctuation where warranted.39

It concludes by instructing the Service Secretaries to insure that the procurement sections of their respective agencies are cognizant of the problems and various techniques for getting through the current period of price instability.40 This welcome policy change at the De-

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38 BNA Federal Contracts Report 539 (July 15, 1974).
39 Id. at A-23.
40 Id.
partment of Defense should pave the way for meaningful action by the Contract Adjustment Boards on the inflation front.

B. **Essentiality to the National Defense**

Assuming that a contractor has passed the impairment test, he must still meet the regulatory standard of "essential to the national defense." This standard, however, encompasses a wide variety of goods and services; for example, electronic components and systems, dairy supplies, back-up aircraft radio receivers, airfield communications equipment, generator sets, and ammunition components. Thus, the nature of articles or services provided has not posed any serious obstacle to the Boards' granting relief in otherwise appropriate cases. Relief has not been limited to producers of first-line combat equipment. Moreover, "essentiality" does not require a contractor to establish that he is a sole source, but only that his productive capacity is needed and cannot be replaced by an alternative source within reasonable constraints of time or money. A time lag of from three to eighteen months in securing replacement items has been held sufficient, as has an excess cost of 21% or greater.

The excess cost criterion should be easily met in severe inflation cases, since the cause of the applicant's losses would by definition be applicable to any alternative producer of the same item, e.g., a drastic rise in the price of labor or materials. However, the other half of the test—the time criterion—is less readily satisfied. Under current decisions, relief would not be available to the producer of a common, off-the-shelf item, notwithstanding a drastic unforeseen increase in the price of labor or materials. Here again, the Depart-

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42 Servite Int'l, Ltd., NCAB (5 Nov. 1973), 2 ECR ¶ 201.
44 Doughboy Indus., Inc., ACAB 1089 (23 Feb. 1968), 2 ECR ¶ 54.
47 E.g., Hol-Gar Mfg. Corp., AFCAB 221 (7 Feb. 1974) (unpublished decision) (12-15 months and approximately 21% excess cost); Servrite Int'l, Ltd., NCAB (5 Nov. 1973), 2 ECR ¶ 201 (12 months and about $1 million annually); S. W. Electronics & Mfg. Corp., NCAB (27 Oct. 1971), 2 ECR ¶ 147 (12-18 months and approximately 100% excess cost); Doughboy Indus., Inc., ACAB 1089 (23 Feb. 1968), 2 ECR ¶ 54 (12-16 months, excess cost not specified); Memcor, Inc., ACAB 1080 (12 Sept. 1969), 2 ECR ¶ 17 (7-8 months and overall loss of $11 million); Belock Instrument Corp., ACAB 1049 (17 Aug. 1962), 1 ECR ¶ 135 (3-8 months and approximately 31% excess cost).
48 See Lane Sales, Inc., ACAB 1169 (4 Nov. 1974) (unpublished decision) (relief denied where "there are other contractors who can supply similar products . . .").
ment of Defense policy memorandum of June 12, 1974,\(^a\) appears to call for some broadening of the standards applied by the Boards. It is reasonable to argue, for example, that at least the unprecedented short-term spurt of inflation caused by the energy crisis should be met by a temporarily broadened definition of "essentiality" to include all companies that produce necessary defense-related items, whether or not more than one source is readily available. If not, the burden of those inflated prices will fall inequitably on the producers who by mere chance hold contracts negotiated between 1972 and 1974, which no doubt includes many of the most highly valued producers of defense-related material.

C. The Scope of Relief Granted for Essentiality

The monetary relief necessary in inflation cases should be related to the extraordinary and unforeseen increases in labor or material costs experienced by contractors. However, the regulations that presently govern "essentiality" cases prescribe relief in terms of "the extent necessary to avoid such impairment to the contractor's productive ability."\(^b\) As interpreted by the Boards this standard bears no necessary relation to the amount of the loss suffered. In one case involving a five-year contract term, the Navy Board limited relief to a one year period which represented the time required to establish another comparable source.\(^c\) In another, the Board limited relief to the minimum necessary to complete the contracts in question and additionally imposed the strictures of an advance payment controlled account, and even specified that $150,000 of the amount granted should be "the corpus of a loan which shall be subject to the terms of a loan agreement . . . ."\(^d\)

However, two recent cases both involving inflation suggest that the Boards may be moving toward a broadened interpretation of the regulation. In Allegheny Metal Stamping Co.,\(^e\) the Army Board granted $129,257 out of the $158,163 requested in order to permit continued production and contract completion, and in addition authorized the contracting officer to include an escalation clause to cover future increases in the costs of the copper and steel.\(^f\) The latter

\(^a\) See note 38 \textit{supra}.
\(^b\) 32 C.F.R. § 17.204-2(a) (1974). \textit{See also} 41 C.F.R. § 1-17.204-2(a) (1974).
\(^c\) Servrite Int'l, Ltd., NCAB (6 Nov. 1973), 2 ECR ¶ 201, at 5.
\(^f\) Id.
provision clearly had the effect of relieving the contractor of future losses due to material price increases, whether or not such future increases would impair his ability to complete the contracts. In Amron Corp., the Army Board relieved the contractor of virtually all loss on the contract attributable to increases in the price of brass. The contractor projected his loss at $553,748; the Board granted $549,871 on the basis of audit substantiation of the loss figure. The award was made without regard to any amount necessary for the contractor's continued production on any particular contract.

III. Inflation Cases and "Mutual Mistake as to a Material Fact"

A second avenue of relief of potentially great importance to contractors with serious inflation losses is the "mutual mistake" rule. Regulations provide that "[a] contract may be amended or modified to correct or mitigate the effect of a mistake, including . . . a mutual mistake as to a material fact." As applied by the Boards so far, this provision has had only limited application to inflation cases. It may become of much greater significance if the present inflation crisis results in a spurt of new cases before the Boards.

A. Material Facts in Existence as of the Date of Contract Awards

Relief for mutual mistake has not generally been granted unless the parties were mistaken as to some material fact in existence as of the date of contract award. For example, in J. A. Maurer, Inc., both parties entered into a contract on the assumption that a particular type and brand of photographic film would be available for use throughout performance. In fact, however, the film manufacturer had discontinued production fifteen months prior to the contract award and a new and different film had to be used, resulting in increased

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ACAB 1155 (1 May 1974), 3 ECR ¶ 8.

Id. ¶ 8, at 3.

32 C.F.R. § 17.204-3(c) (1974). The same provision is included in the Federal Procurement Regulations, 41 C.F.R. § 1-17.204-3 (1974). Both regulations also refer to mistakes or ambiguities as to what was intended to be expressed in the written instrument, and obvious mistakes on the contractor's part that should have been apparent to the contracting officer prior to award. However, neither of these latter provisions appears to be applicable to mistakes arising out of increases in the inflation rate. For typical applications of these provisions, see, e.g., Northrop Corp., ACAB 1129 (28 Mar. 1972), 2 ECR ¶ 165; General Elec. Co., ACAB 1126 (22 Feb. 1972), 2 ECR ¶ 160.


performance costs. On these facts the Air Force Board found that "the contract and the contracting officer incorrectly assumed at the time of award that Eastman Kodak type SO-1060 film would be available . . . ." and granted the requested relief. In *Genisco Technology Corp.*, both parties relied, in entering into the contract, on a feasibility study setting forth certain technical solutions that had been prepared by another contractor. Some of these technical solutions later proved to be faulty and contract costs increased accordingly. Relief was granted by the Board "on the ground of mutual mistake."

Conversely, relief has generally been refused for mere errors in judgment in forecasting future events, including unanticipated inflation. In *Servrite International, Ltd.*, the contractor claimed relief under mutual mistake for unanticipated inflationary wage and cost increases in Italy, alleging that both parties failed to anticipate the extraordinary rate of inflation and also failed accurately to assess the Italian labor market. However, the Navy Board rejected this theory of recovery:

In this case, the parties do not contend that they were in error with regard to a fact existing at the time of contracting, but rather, *mutual mistake is theorized on the basis of the parties inability to foresee the future: in essence, to prophesize the occurrence of abnormal inflation. The Board does not consider this lack of foresight to constitute a mutual mistake upon which relief can be granted.*

In *Waterman Steamship Corp.*, the Board denied relief notwithstanding the fact that seamen's wages had increased at a rate that was 480% of what the contractor had projected due to unanticipated high arbitration awards. Because of these increases the contractor's losses under the multi-year ship charter contract were projected at not less that $11.2 million. Notwithstanding the magnitude of the loss, the Board denied relief:

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40 Id. ¶ 77, at 4.
42 Id. ¶ 40, at 5.
44 2 ECR ¶ 201, at 3. Although the Board rejected the contractor's "mutual mistake" theory, relief was granted under the "insolvency" standard. See text accompanying notes 27-28 supra.
45 2 ECR ¶ 201, at 3 (emphasis added).
Waterman erred only in its forecasts of what future events would bring, and a mistake of judgment concerning the extent of future wage increases is a shortcoming which this Board cannot cure as a mutual mistake of fact. Waterman's request for relief on this basis is accordingly denied.\textsuperscript{67}

Despite the strong language of the above cases, there have been exceptions. In \textit{Frank P. Williamson},\textsuperscript{68} the Air Force Board found a mutual mistake where the parties had assumed that the contractor would be able to continue to raise hogs under a garbage removal contract, but where the hogs died and new ones could not be raised on the same land for several years. It seems clear that there was no mutual mistake as to an existing fact in this case. The mistake, if any, was in the failure to foresee future events. Thus, the requirement that there be established a mutual mistake existing at the date of contract award does not constitute a complete bar to otherwise meritorious applications.

\section*{B. Relief Available in Inflation Cases}

The Boards have experienced no difficulty in granting relief in inflation cases where a mutual mistake can somehow be related back to the time of the contract award. In \textit{The Magnavox Corp.},\textsuperscript{69} the parties included an escalation factor based on the Wholesale Price Index for "\textit{Television, Radio Receivers, and Phonographs},"\textsuperscript{70} in a contract for electronics equipment. As it turned out, however, this index consistently went down due to the impact of Japanese imports. Meanwhile, domestic costs went up. The Board determined that the "wrong" escalation index had been used and that if the parties had examined the situation closely at the time of contract award, they would have noted the downward trend of the index and caught the error. From this the Board concluded that relief under "mutual mistake" was appropriate and so ordered.\textsuperscript{71} The same situation arose in

\begin{itemize}
\item \textsuperscript{67} 2 ECR ¶ 99, at 3.
\item \textsuperscript{68} AFCAB 118 (14 June 1961), 1 ECR ¶ 72. \textit{See also} Advance Maintenance Corp., AFCAB 205 (21 April 1970), 2 ECR ¶ 111 (relief granted where the contractor could not reasonably foresee the "prevailing wage rates" that would be set by the contracting officer); Atlas Fabricators, Inc., AFCAB 220 (3 July 1973), 2 ECR ¶ 192 (contractor released from obligation to provide option quantity where material costs had increased 40%).
\item \textsuperscript{69} ACAB 1100 (17 April 1969), 2 ECR ¶ 84.
\item \textsuperscript{70} \textit{Id.} ¶ 84, at 1 (emphasis in original).
\item \textsuperscript{71} \textit{Id.} ¶ 84, at 3.
\end{itemize}
Polarad Electronics, Inc., and the same result was reached.

Relief was also granted in two cases that do not readily fit within the "mutual mistake" rule. Northern Metal Co. involved a contract for terminal services, stevedoring, and processing for vehicles which contained a 10% price escalation limitation "based on general experience known to the parties concerned at the time the contract was entered into." The Board determined that the contractor encountered losses due to two factors: (1) the Army's failure to use the quantity of services earlier predicted; and (2) cost increases above the escalation ceiling. The Board held that the inclusion of the 10% escalation ceiling was not a mutual mistake, but was a unilateral mistake on the part of the government:

5. . . . Setting the limitation at ten percent was a mistake on the part of the government and should be corrected under the authority of Section 17.204.3 of ASPR.

6. The effect of the ten percent limitation under the present circumstances, including the abnormal wage increase negotiated by the ILA, and the substantially reduced tonnage being shipped to contractor's facility by the Government, constitutes an injustice not contemplated by the parties during the prolonged discussions and exchange of information at the time the contract was negotiated. This, as a matter of fairness, should be rectified.

This award is almost a total contradiction of the Board decision in Waterman Steamship Corp.

INDUS, GmbH, involved a contract for the construction and leasing to U.S. military personnel of family housing in Germany. The contract contained a guaranteed rental rate not to exceed $185 per month per unit for a period of ten years, with no escalation. The

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72 ACAB 1116 (27 April 1971), 2 ECR ¶ 134.
73 Id. ¶ 134, at 2. "The Board finds that Code 1-25 was inappropriate and inadequate as a price index in the escalation clause of this contract and that this was a material fact regarding which there was a mutual mistake by the parties to the contract."
75 Id. ¶ 196, at 1.
76 Id. ¶ 196, at 2. The reasoning of the case is confused by the fact that the Board also found the contractor's continued operation to be "essential to the national defense," suggesting that reliance was also placed on the "essentiality" provisions of the regulation.
guaranteed rental rate was equal to the statutory guarantee limitation then in effect. The contractor incurred substantially increased costs and sought relief which the Board granted on the grounds that failure to include an escalation clause covering the guaranteed rental was a "mistake." The Board did not explain what the mistake was or how it arose. It did note that Congress raised the statutory ceiling from $185 to $275 subsequent to negotiation of the contract, thereby implying that the "mistake" was the failure of the parties to foresee that the congressional limitation might change.\footnote{Id. ¶ 2, at 2.}

Altogether, the cases do not chart any clear course for the Boards to follow in today's inflationary situation. It would seem appropriate, however, for the mutual mistake rule to be broadened sufficiently at least to accommodate the drastic price increases occasioned by the 1973-74 energy crisis. These dramatic changes could not have been foreseen in any contracts negotiated either in 1972 or in the first three quarters of 1973. Therefore it could be reasoned with at least as little resort to fiction as in past decisions, that the failure to include adequate escalation clauses in these contracts constituted a mutual mistake within the meaning of the regulation.

C. Scope of Relief Granted

Relief in mutual mistake cases may take the form of whole or partial rescission of the contract at no cost to either party.\footnote{E.g., Frank P. Williamson, AFCAB 118 (14 June 1961), 1 ECR ¶ 72 (cancellation of the entire contract at no cost to the government); Atlas Fabricators, Inc., AFCAB 220, (3 July 1973), 2 ECR ¶ 192 (rescission of the option quantity at no cost to the government).} However, in a number of cases a remedy resembling reformation has been granted, resulting directly or indirectly in a price increase.\footnote{INDUS, GmbH, ACAB 1152 (9 Jan. 1974), 3 ECR ¶ 2 (authorization to negotiate an escalation clause that would result in higher guaranteed rentals for the contractor); Northern Metal Co., ACAB 1146 (29 Aug. 1973), 2 ECR ¶ 196 (removal of escalation ceiling and payment of an amount representing the contractor's loss); Polarad Electronics, Inc., ACAB 1116 (27 April 1971), 2 ECR ¶ 134 (substitution of a new escalation index, resulting in a price increase of $165,399); Advance Maintenance Corp., AFCAB 205 (21 April 1970), 2 ECR ¶ 111 (price increase of $46,684 to compensate for higher than reasonably foreseeable "prevailing wage rates").} And in a few cases, the remedy has approximated an "equitable adjustment" for increased costs under the Changes Clause.\footnote{J. A. Maurer, Inc., AFCAB 200 (28 Jan. 1969), 2 ECR ¶ 77 (compensation for increased costs caused by the nonavailability of a specific photographic film); Genisco Technology Corp., NASACAB (20 Oct. 1967), 2 ECR ¶ 40 (compensation for increased costs caused by mistaken assumptions as to the feasibility of certain technical solutions).} Any of these remedies...
may be appropriate in a given inflation case—*i.e.*, rescission where the contractor has yet to incur any substantial cost under the contract, and reformation or equitable adjustment where continued performance is considered to be in the government's best interest.

Hence, the remedies presently available for mutual mistake are adequate to meet the equities of inflation cases.

IV. LOSSES DUE TO GOVERNMENT ACTION: THE SOVEREIGN ACT RULE AND ITS EXCEPTIONS

One other area in which recovery has been allowed under Public Law 85-804 should be closely examined. Regulations provide that relief may be afforded "[w]here a contractor suffers a loss (not merely a diminution of anticipated profits) on a defense contract as a result of Government action ... ." The regulation goes on to state that "[w]here the government action is directed primarily at the contractor and is taken by the Government in its capacity as the other contracting party, the contract may be adjusted ...." This latter provision has been read to create a sovereign act rule in "government action" cases, and to close the door firmly on relief where the only acts complained of are those of the government in its general capacity, such as embargos, devaluations and inflationary economic policies or actions.

In *S. W. Electronics & Manufacturing Corp.*, a contractor asked for relief on the grounds that a government embargo on shipments to Pakistan created a severe loss situation that threatened his performance on other government contracts. However, the Board found that the government act complained of equally affected all United States firms and accordingly ruled that no basis for granting relief existed. In *R. E. Lee Electric Co.*, the contractor complained that increased government demand for copper had led to a drastic price rise. However, the Board denied relief, labeling the facts as "classic examples of sovereign acts for which relief is not ordinarily granted." In *Fargo Shipping Corp.*, the contractor's application was based on the government's action in drastically increasing the demand for charter ships, thus sending the market rate up and leading to drastic

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32 C.F.R. § 17.204-2(b) (1974). *See also* 41 C.F.R. § 1-17.204-2(b) (1974).
32 C.F.R. § 17.204-2(b) (1974).
*Id.* ¶ 147, at 1.
2 ECR ¶ 87, at 7.
NCAB (8 Feb. 1968), 2 ECR ¶ 52.
cost increases such as wages. Again the Board determined that the action complained of was a sovereign act:

No allegation is made by the Contractor that the Government's direction of the vessel was contrary to the terms of the subject Contract. It is clear that the other Government actions cited were not directed primarily at the Contractor and were not taken by the Government in its capacity as the other contracting party; nor were they otherwise of such a nature as to warrant an amendment without consideration under Public Law 85-804. Accordingly, no grounds for relief on the basis of Government action are established.\(^9\)

An exception to the rule exists, however, and a contractor may be granted relief, if he can establish some additional government act in a contractual capacity apart from the inflationary price increases. For example, in *Alabama Industries, Inc.*,\(^1\) drastic cost increases were coupled with the government's exercise of an option, at a time when the government knew that the contractor would suffer a tremendous loss thereby. These facts were found to constitute the requisite "government action."\(^2\) Other cases suggest that a similar result might be reached if inequitable government conduct of some kind against the particular contractor can be established,\(^3\) such as failure to include a required escalation clause,\(^4\) or a pre-award representation that "a price increase would be negotiated in the event of an increase in the

\(^9\) *Id.* ¶ 52, at 3 (emphasis in original).

\(^1\) ACAB 1150 (6 Nov. 1973), 2 ECR ¶ 202.

\(^2\) *Id.* ¶ 202, at 2.

The Board finds that at the time the Government unilaterally exercised its option, the Government was placed on notice that if the option were exercised that a loss would occur. If the facts were investigated, a disastrous financial situation would have been confirmed. The Board determined that under these circumstances it was not in the interest of the Government to require performance under the option so as to cause the financial ruin of the company. Accordingly, the Board finds that in fairness there should be some adjustment to the contract.

*Id.*

The contractor also alleged that defective Government furnished equipment contributed to this loss. Relief was apparently based on "government action" and "essentiality."


minimum wage." Other government actions of a similar nature might be prolonged delays between bid opening and award, delay in furnishing notice to proceed, or delay in approval of first article samples or of subcontracted supplies or materials. Any of these government actions, and others, may create valid future exceptions to the sovereign act rule.

On a broader plane, the sovereign act rule itself is a legal doctrine transplanted from federal procurement law and has no logical role to play where purely equitable considerations are at issue. It serves as nothing more than an arbitrary bulwark to confine the otherwise broad sweep of the "government action" remedy. Although the risk of a flood of applications for relief exists in today's unparalleled inflation crunch, policy makers in the Defense Department and in the other departments and agencies should nonetheless consider whether a more flexible approach might not better serve the government's interests. The Department of Defense policy memorandum of June 12, 1974 may at least provoke some thoughtful reconsideration of this issue.

V. The Residual Powers

Departments and agencies have narrowed by regulation the broad sweep of Public Law 85-804 and limited residual action for the most part to the categories described earlier in this article. What remains of the statute outside the explicit regulatory provisions is known as the "residual powers."

Although often invoked by contractors in their Public Law 85-804 applications, the residual powers have seldom been relied upon by the Contract Adjustment Boards in their decisions. In one case, a contractor submitted his application under "formalization of an informal commitment," but the Board expressed doubt as to the

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95 Id. ¶ 80, at 5.
96 E.g., Horowitz v. United States, 267 U.S. 458, 461 (1925).
97 As late as 1967, it was unclear what the regulation meant, and whether it in fact established a "sovereign act" rule at all. See Jansen, Public Law 85-804 and Extraordinary Contractual Relief, 55 Geo. L.J. 959, 981-83 (1967).
98 See note 38 supra.
101 Samdo Forest Co., AFCAB 188 (17 Aug. 1966), 2 ECR ¶ 16.
applicability of that provision, and granted relief alternatively “under its residual powers” on the grounds that the contractor had furnished necessary goods to the Air Force but for which he had not been paid.\textsuperscript{103} In a similar situation, a contractor completed work in excess of the contract limitation without an informal commitment. The Board’s decision under its residual powers was based on the fact that immediate completion of the work undoubtedly saved a substantial amount of government funds and was “in the best interests of the Government . . . .”\textsuperscript{104} In yet another case, the Board again failed to find a basis for relief under an “informal commitment,” but stated that it had the general power to act in unusual cases if action was warranted.\textsuperscript{105} The Board found justification for granting relief in the fact that the contractor was a foreign national and that relations would be enhanced “by providing a procedure whereby misunderstandings arising overseas concerning defense procurement may be resolved.”\textsuperscript{106}

With these few exceptions, Boards appear reluctant to abandon the fairly precise regulations governing categories of remedial action. They are hesitant to set themselves adrift with little more than the statute to guide them. Thus, there are no inflation cases explicitly resting on the remedial powers,\textsuperscript{107} notwithstanding the unquestioned sufficiency of the statute to meet the inflation situation. Explicit guidance well beyond the Department of Defense policy memorandum of June 12, 1974,\textsuperscript{108} would appear to be required if Boards are to be encouraged to meet the inflation problem head on through use of the residual powers.

VI. RELIEF AVAILABLE TO SUBCONTRACTORS

Regulations provide that any person seeking an adjustment may file a request with the appropriate Board.\textsuperscript{109} Accordingly, Boards have

\textsuperscript{103} 2 ECR ¶ 16, at 6-7.

\textsuperscript{104} Anderson Bros. Lumber Co., AFCAB 189 (6 Oct. 1966), 2 ECR ¶ 18, at 3.

\textsuperscript{105} Jin Up Kim, ACAB 1103 (15 July 1969), 2 ECR ¶ 92.

\textsuperscript{106} Id. ¶ 92, at 3.

\textsuperscript{107} But cf. INDUS, GmbH, ACAB 1152 (9 Jan. 1974), 3 ECR ¶ 2; Atlas Fabricators, Inc., AFCAB 220 (3 July 1973), 2 ECR ¶ 192; Advance Maintenance Corp., AFCAB 205 (21 April 1970), 2 ECR ¶ 111. The reasoning in all of these cases is unclear enough to permit a “residual powers” interpretation.

\textsuperscript{108} See note 38 supra.

\textsuperscript{109} 32 C.F.R. § 17.207-1 (1974); 41 C.F.R. § 1-17.207-1 (1974); 41 C.F.R. § 18-17.105-1 (1974). The AEC regulation provides explicitly that “[A] request . . . may be made by any party who performs services for or furnishes material or facilities to the AEC, either directly or indirectly.” 41 C.F.R. § 9-17.207-1 (1974).
uniformly accepted applications by subcontractors, though they are generally submitted through and sponsored by the prime contractor.\textsuperscript{110} However, agreement by the prime does not appear to be a firm requirement. In \textit{Aeronca Manufacturing Corp.},\textsuperscript{111} the Army Board found that there are situations where direct requests from subcontractors are appropriate:

\ldots while AERONCA is a subcontractor rather than a prime contractor, it is also well settled that relief may be granted to a subcontractor in an appropriate case . . . . Although the examples of the types of cases listed in Section XVII of ASPR do not deal with an application for relief submitted directly by a subcontractor (instead of through a prime contractor) they are not considered to exclude other cases where the Board determines that the circumstances warrant action (ASPR 17-204.1).\textsuperscript{112}

In another case, direct relief was afforded to a subcontractor where the prime contractor refused to cooperate.\textsuperscript{113} Hence, there should be no barrier to the direct submission by subcontractors of inflation cases under Public Law 85-804.

VII. Conclusion

The promise of Public Law 85-804 lies in the great flexibility that it vests in the executive branch to deal with unusual and unforeseen crises in the government contracting field\textsuperscript{114} which is otherwise so heavily encrusted with complex regulations, decisional pitfalls, and intricate limitations of authority. The government has not yet revealed whether it will use this authority on any substantial scale to deal with the crunch of double-digit inflation. Past decisions of the Contract Adjustment Boards, if followed in the future, would impose serious limitations on the use of Public Law 85-804 in connection with the inflation crisis.

Use of the authority, however, could and should be reasonably broadened, with appropriate safeguards to prevent its abuse. Contractors and subcontractors should be held to a reasonable standard


\textsuperscript{111} ACAB 1069 (6 April 1967), 2 ECR ¶ 32.

\textsuperscript{112} Id. ¶ 32, at 5.

\textsuperscript{113} Elgin Nat'l Watch Co., ACAB 1064-A (20 Oct. 1965), 1 ECR ¶ 225.

of foreseeability, that is to the reasonably foreseeable inflation rate as of the date of their contracts. Their performance thereafter in the purchase of materials or components and in the provision of labor, should be judged by a standard of the reasonably prudent businessman. Increased costs subject to redress under Public Law 85-804 should be limited to those that can be shown to be due to unforeseeable inflation in labor, materials or other costs. Conversely—to turn the sovereign act rule around—the only inflation-based increased costs subject to redress should be those that would have occurred regardless of the identity of the particular contractor.

The type of remedy afforded ought equally to be subject to restraint. For example, the primary remedy could be release from the contract where that can be accomplished equitably which generally would be prior to the incurrence of the inflated costs. Relief in the form of reformation and monetary compensation could be limited to situations where release from the contract is not feasible or equitable, or where the government's best interests require that the contract continue.

It can be forcefully argued that this solution is itself inflationary. However, anti-inflationary policy must give way to equitable considerations at some point. Moreover, a limited broadening of relief under Public Law 85-804 may be less inflationary in the long run than a wholesale exodus of commercial enterprise from the government contracting field. This latter result, which is a distinct threat today, would inevitably reduce competition for government business and increase the prices the government must pay for years to come.