

LIABILITY FOR LOSS, DAMAGE, DESTRUCTION, OR THEFT OF GOVERNMENT PROPERTY IN THE POSSESSION OF CONTRACTORS

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The views expressed herein are those of the author and do not necessarily reflect the views of the Defense Acquisition University or the Department of Defense.

I have lectured extensively about the issue of liability. It is one of my FAVORITE areas – and one that is much misunderstood, and even more disturbing, much misapplied – by even the most experienced Government Property Administrator and Contractor employee. Therefore, with the rewrite of FAR Part 45 it seems a propitious time to resurface the topic and expand the depth and breadth of discussion. I will cover the two most frequently used forms of liability – the “full” risk of loss provisions and the “limited” risk of loss provisions. And yes, in this article, the Drunken Forklift Operator WILL ride again!!!

As this is a revisitation of Liability, I have learned a few things since last writing about this topic:

1. People generally respond EMOTIONALLY to this topic! We often hear the following, “You lost, damaged or destroyed my property! How could you? Well, you’d better PAY UP!” Maybe – maybe not! Emotion, whether on the part of the Government Property Administrator, Commanding Officer, Contracting Officer or the contractor’s personnel – either managerial or property clerk, has no place in the determination of liability under a contract. Disregard all of your emotional baggage and think purely analytically.
2. People do not READ THE CONTRACT! I cannot tell you the number of times that I have had a telephone call from a property professional in the field. They say, “We just had an incident where the contractor destroyed some Government property. Are they liable?” How should I know? First off – READ THE CONTRACT! Which Government Property Clause is in the contract? Until you have determined this first step, all other determinations are for naught.
3. Bosses generally respond emotionally. Read item 1 above. Regardless of how much analysis the Government Property Administrator has engaged in – his or her boss responds in an emotional fashion. Emotion has no place in this determination.

So, with that said let’s have at it -- a discussion of the TECHNICAL issues of Liability for loss, damage or destruction of Government property in the possession of contractors.

For the traditional liability provisions (Full and Limited), I plan to divide this discussion into five parts. These parts consist of:

- The Government’s Policy
- The Clausal Requirements
- Why?

- The Contractor Property Administrator Responsibilities, and
- The Government Property Administrator Responsibilities.

I plan to walk through these parts in an attempt to establish the various relationships that exist between all of the players as well as provide a firm regulatory and legalistic perspective so all of us may understand the workings of the liability process and product.

THE GOVERNMENT'S POLICY

The Federal Government's official policy towards liability for loss, damage or destruction is contained within the Federal Acquisition Regulation (FAR) at 45.104. entitled "Responsibility and Liability for Government property." It states

"(a). Generally, contractors are not held liable for loss, damage, destruction, or theft of Government property under the following types of contracts --

- (1) Cost reimbursement contracts;*
- (2) Time and material contracts;*
- (3) Labor hour contracts; and*
- (4) Negotiated fixed price contracts for which the price is not based upon an exception at FAR 15.403-1."*

The first part of this sentence seems simple enough; generally the contractor is not held liable for the loss, damage, destruction, or theft of Government property. O.k., the contractor is not liable. But the Government added that simple word – GENERALLY. What does this mean? Simply put, there are situations where the Government MAY REQUIRE that the contractor be held liable or there may be actions taken or not taken that cause a contractor to be liable. Can the Government change its mind and say that the contractor IS responsible and liable for Government property? Yes, there are! We have to consider the second part of the sentence where a variety of contract types are listed.

These include:

- (1) Cost reimbursement contracts;
- (2) Time and material contracts;
- (3) Labor hour contracts; and
- (4) Negotiated fixed price contracts for which the price is not based upon an exception at FAR 15.403-1.

Under these SPECIFIC types of contracts it is the GENERAL policy that contractors are NOT liable for the loss, damage, destruction, or theft of Government property. In this case the "Limited Risk of Loss" provision of the Government property clause is applicable, specifically FAR 52.245-1(h).

But there are OTHER types of contracts and even situations where the contractor IS held Liable. There is one pricing arrangement that is NOT included within the four listed above – that is a FIRM FIXED PRICE Contract – where an exception at FAR 15.403 APPLIES. If a FIXED PRICE contract is awarded the contracting officer may require the contractor to be liable for the loss, damage, destruction, or theft of Government property. The

contracting officer would do this through the inclusion of the Alternate I to FAR 52.245-1 – what is referred to as at “Full” risk of loss provision.

Lastly, in this policy section there is one other point of discussion regarding loss, damage, destruction or theft of Government property. FAR 45.104 additionally states,

“The contracting officer may revoke the Government’s assumption of risk when the property administrator determines that the contractor’s property management practices are inadequate and/or present an undue risk to the Government.”

I am not going to discuss the "WHYS" at this point. I will leave that for later. From this perspective, we should be able to see, or at least have some idea, that there appear to be two forms of liability emerging – Our initial statement that under certain types of contracts the contractor is generally not held liable that under another type of contract the contractor is liable for government property. “But wait a minute,” you say, “This section, FAR 45.104, is policy, and I’m a contractor, and policy is not binding upon me unless implemented through some type of contractual obligation.” Let us see where this implementation occurs.

CLAUSAL REQUIREMENTS

The first place for us to look for a contractual obligation would be the Government Property clauses. It would be logical to also look at the simplest form of contract - the Fixed Price contract. It is important to note that this analysis will deal first with the FULL risk of loss provision and then with the LIMITED risk of loss.

Firm Fixed Price Contract

The Fixed Price Government Property Clause is found at FAR 52.245-1. The specific section of this clause that deals with liability is found at Alternate I, paragraph (h). It states,

“The Contractor assumes the risk of, and shall be responsible for, any loss, damage, destruction, or theft of Government property upon its delivery to the Contractor as Government furnished property. However, the Contractor is not responsible for reasonable wear and tear to Government property or for Government property properly consumed in performing this contract.”

It's nice to be able to cite the FAR but we must go one step further and interpret its meaning. Very simply, under this clause the Contractor is responsible for **ALL** loss, damage and destruction of Government Property - REGARDLESS OF HOW IT HAPPENS! Whether it was a loss through theft, damaged through fire or flood, or destroyed through a California earthquake makes no difference whatsoever. The Contractor is still liable!

We do see two exceptions here though. One is for reasonable wear and tear, the other for proper consumption. For instance, if a contractor is provided, as Government Furnished Property, some Special Tooling (ST) under this fixed price contract. The Government, would be unreasonable if they were to expect to receive that tooling back in the exact same

condition as when it was provided. The Government realizes and expects there to be usage of the ST and therefore expects there to be "reasonable wear and tear." Likewise, if Government Property of the material classification is provided under this contract we would expect there to be reasonable consumption. With this responsibility for "ALL" loss, damage or destruction one would think a contractor reasonably prudent if they carried insurance. Since this contract was or is based upon adequate price competition, there is no problem with this. The Government realizes that, in this instance its burden of the risk, the insurance risk for the protection of the Government property, is not inordinate and therefore there is no prohibition against the carrying of insurance.

One problem that arises with this provision is the operationalization of the word "**ANY**." For example, let's assume that a contractor working under a fixed price contract containing this clause, FAR 52.245-1 with the alternate I, paragraph (h), loses an item of ST. This ST's original acquisition cost was \$200. Unfortunately, it was also ten years old and had seen better days. Upon its loss the contractor reports the loss to the Government Property Administrator (PA). The Government PA reviews the contract, sees this clause and makes the determination that the contractor should be held liable and forwards the recommendation to the Administrative Contracting Officer (ACO) for review and determination. (Note – the PA DOES NOT have the AUTHORITY to HOLD the contractor liable. That is a CO Function!) The ACO gets the letter and sends for the PA. "I am going to hold the Contractor liable for this lost Special Tooling," says the ACO. "How much should I assess as the value of the lost Special Tooling?" The PA says, "The Acquisition cost -- that is the cost at which all of the Government Property records are maintained."¹

Are you sure about the AMOUNT for assessment of Liability?

Consider for a minute - What value would you assess for the lost ST? Ah, I hear the shouts already.

"The ST was ten years old, we want to offer depreciated cost."

"Wait a minute, I want appreciated value - that ST would cost more now to fabricate or acquire than it did ten years ago."

"Hey, it was nothing more than scrap. I'll give you SCRAP value!"

"But, I still need it, so I want it replaced or provide me REPLACEMENT value!"

Think about it. In the last few sentences we have had multiple different values applied to that one item of ST. Acquisition Cost, Depreciated Cost, Appreciated Cost, Scrap value! Which one does the ACO apply? So far, we have no guidance as to **HOW MUCH** a contractor should be held liable for. In fact, up until 1985 the ONLY value PAs were to apply was the original acquisition cost. But in 1985 things changed. It just so happens that a court decision has provided us some guidance. It seems that there was a contractor in California who was awarded a fixed price contract for the processing and developing of some motion picture film of Army Troop Movements over in Korea, provided as

¹ It is important to note that we are addressing the record established by the contractor. Yes, the Government in its financial accounting processes will depreciate the property. But that is different than the contractor applying and recording depreciation for Government property in its records.

Government Furnished Property. This contract contained the old FAR Fixed Price Government Property clause 52.245-2 with the regular paragraph (g) Risk of Loss provision – essentially the FULL risk of loss provision. The contractor lost the film. What value should the Government recoup for this lost film?

Think about your own life and experiences for a moment. We bring our film to be developed, as an example, to the local Wal-Mart (I picked Wal-Mart because they are ubiquitous! No infringement of the trademark is intended nor is this an endorsement of their services or products). We receive a receipt for the film that states the company's liability is limited, and if they lose the film they will provide us a new free role of film. That's all, nothing else. Although our Aunt Tillie's last pictures, may she rest in peace, were on that roll of film, and she meant a lot to us, all that we are going to receive from Wal-Mart is a free role of film.

Well, the contractor made the same claim. They were willing to provide the Government a new free role of film. The ACO was not too pleased with this decision and, needless to say, there arose a dispute which ended up in the hands of the Armed Services Board of Contract Appeals. The Armed Services Board of Contract Appeals (ASBCA), one of the avenues of appeal that contractors may take when they disagree with the Government's decision(s), reviewed the FAR and the Department of Defense Federal Acquisition Regulation Supplement (DFARS) and could find no direction as to what value should be placed on the lost film. Furthermore, they could find no federal contract decision addressing this point. Therefore, they went to state law and they decided to seek professional help. They asked Judge Wapner, Judge Judy, Judge Brown and every other Judge that is out there on TV. (Just joking folks, disregard these last two sentences.) Since there was an absence of either statutory or contractual limitations, they used the common law applied by the state courts in similar cases. They placed that value as the "**value of the film to the owner**" or the **INTRINSIC value**. This is a critical point for it is this ruling that decided for the Government the issue of "how much." In this case it was not only the cost of the film, that new role, per se, but it also included the cost of flying the film crew back over to Korea and reshooting the film. (ASBCA No. 29,831, Dynalectron Corporation, July 31, 1985).²

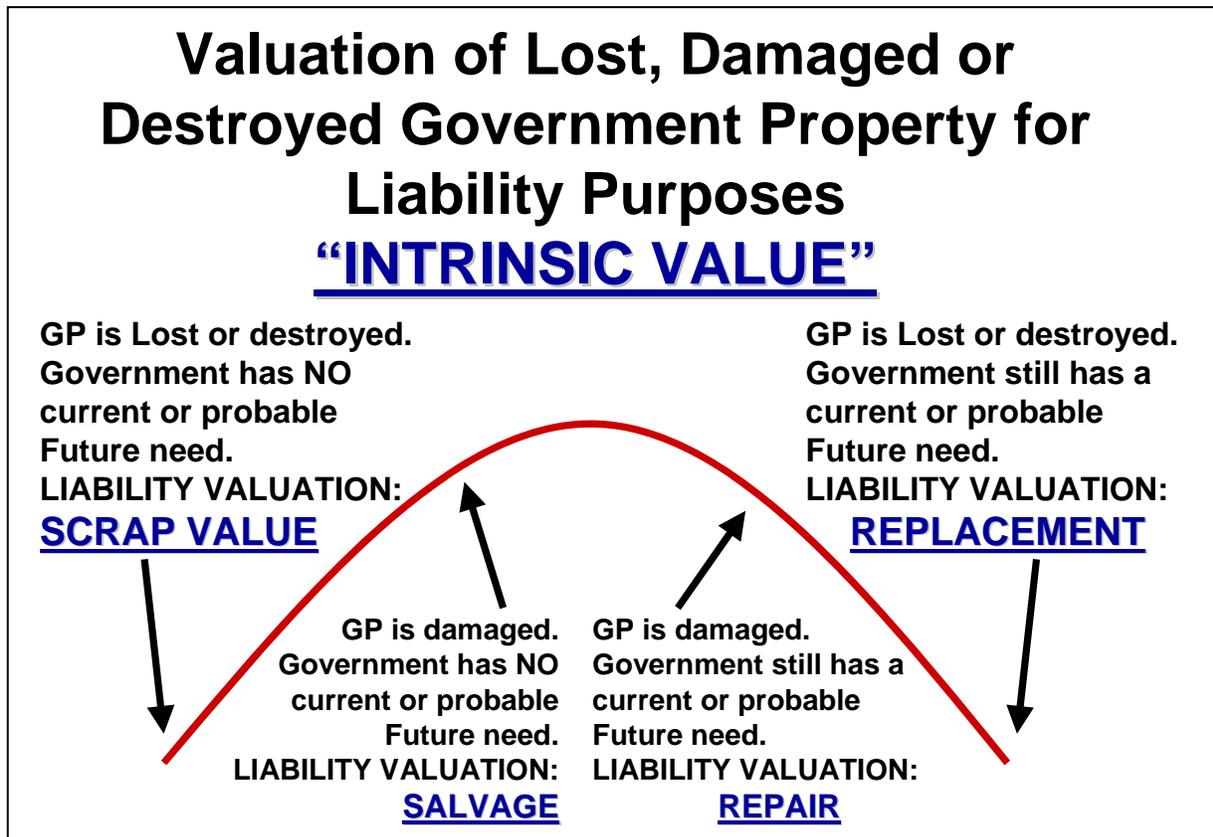
Let us go back to that item of ST. Now, in light of this decision, for how much is the contractor liable? "Replacement or appreciated cost" one says. "But the Government doesn't need it anymore; it was worthless junk" someone else says. I believe that this ruling is a two-edged sword. Consider that if the government, acting in good faith, claims that there is still a continuing need for that ST. Then the contractor may be assessed for **Replacement** cost. If the Government no longer has a need for that item of ST then it may very well be a **Depreciated** Cost. "But the Government doesn't depreciate its property," you say.³ How do I know what the depreciated cost is? More likely than not that cost will

² Small note – to add insult to injury Dynalectron was still required to process the replacement motion picture film under its contract with the United States Government.

³ This statement is changing due to changes in the Financial Management regulations due to the Chief Financial Officer Act of 1990, which required the Government to handle itself more like a commercial

be nothing more than scrap value - pennies on the pound for tool steel.

Below is a chart providing a visual reference as to the different degrees of valuation.



Why should the PA care how much the contractor is liable for? Let the ACO worry about that. I beg to differ. If we were to reference DFARS and its original documents giving us the historical perspective, we would find the Armed Services Procurement Regulation, alias the Defense Acquisition Regulation Supplement 3, Part S3-602.2 (e)(ii). We find that one of the PA's responsibilities is not only to make those recommendations as to the contractor's liability but also as to the amount thereof. It is the PA's job and responsibility to make this recommendation. More on the PA's responsibilities later.

Let us move on to the next type of contract and Liability concept.

Fixed Price Negotiated Contract

There are other types of fixed price contracts with Government Property clauses where the clauses may not have the original language. Rather, they have the REGULAR Paragraph (h) of the clause. Remember that in the policy cited in 45.104 certain fixed price contracts generally do **NOT** hold the contractor liable. These are fixed price contracts of the Negotiated variety. This is our second form of liability - Liability under Fixed Price

business, inclusive of maintaining of a general ledger.

Negotiated Contracts or more frequently referred to as "**Limited Risk of Loss.**" There are certain conditions that must be met for this type of contract to be used as well as for this risk of loss policy and provision to apply. Again, this is used when the contract price is not based upon (i) adequate price competition (ii) established catalog or market prices of commercial items sold in substantial quantities to the general public, or (iii) prices set by law or regulation – or moiré significantly, the contractor is required to submit a certificate of current cost and pricing data (See FAR 15.403).

The Government Property Clause, FAR 52.245-1, used in this negotiated contract is the same as under our original fixed price sealed bid contract with one major exception. The Government Property clause now uses REGULAR Paragraph (h) versus the Alternate I as required by 45.107(a)(2). This paragraph (h) is entitled "Contractor Liability for Government Property." Let us start with paragraph (g)(1). Here we see the statement that

*"Unless otherwise provided for in the contract, the Contractor shall **NOT** (Emphasis added) be liable for loss, damage, destruction, or theft to the Government property furnished or acquired under this contract, except when any one of the following applies:*

We have a reiteration of the theme set forth as policy in 45.104. Contractors are not liable for loss, damage, destruction or theft (L,D,D&T) unless it occurs under very specific circumstances. Here comes the tough part where we must carefully dissect the paragraphs describing under exactly what circumstances the Government may hold the Contractor liable.

Para. (h)(1(i)) " The risk is covered by insurance or the Contractor is otherwise reimbursed (to the extent of such insurance or reimbursement).

(ii) The loss, damage, destruction, or theft is the result of willful misconduct or lack of good faith on the part of the Contractor's managerial personnel. Contractor's managerial personnel, in this clause, means the Contractor's directors, officers, managers, superintendents, or equivalent representatives who have supervision or direction of all or substantially all of the Contractor's business; all or substantially all of the Contractor's operation at any one plant or separate location; or a separate and complete major industrial operation.

(iii) The Contracting Officer has, in writing, withdrawn the Government's assumption of risk for loss, damage, destruction, or theft, due to a determination under paragraph (g) of this clause that the Contractor's property management practices are inadequate, and/or present an undue risk to the Government, and the Contractor failed to take timely corrective action. If the contractor can establish by clear and convincing evidence that the loss, damage, destruction, or theft of Government property occurred while the contractor had adequate property management practices or the loss, damage, destruction, or theft of Government property did not result from the contractor's failure to maintain adequate property management practices, the Contractor shall not be held liable."

Let's analyze the three statements one at a time.

Here we see the first circumstance or condition under which the Government may hold the contractor liable. If conditions warrant, the Government may require the contractor to carry insurance for a specific risk. But the contractor is only liable for that property covered by the insurance as well as only up to the amount of insured protection. In other words, if the insurance were for a face value policy of \$10,000 and the lost property was for \$12,000, the contractor's liability would be limited only to that \$10,000 policy. There is an important item to note here. Contractors ordinarily CANNOT charge the Government for insurance on Government property – unless it is specifically directed to be acquired by the Government. Sub-paragraph (5) of paragraph (h) alludes to this prohibition.⁴ It states

"The allowability of insurance costs shall be determined in accordance with Part 31.205-19."

The Government realizes that since this contract was or is not based upon adequate price competition, in this instance its burden of the risk, the insurance risk, for the protection of the Government property is or would be inordinate and therefore there is a prohibition against the carrying of insurance. I'll talk about this concept under the heading of WHY?

Our second circumstance deals with incidents where, though no specific demand for insurance is made by the Government, such as required earlier, there is in fact insurance coverage. The most obvious example of this requirement is your personal car insurance. A company employee is driving into the company parking lot and accidentally hits a piece of Government property, damaging it. Is the contractor required to carry insurance to cover this damage? Generally, no! Then how can there be a "risk that is 'in fact' insured?" Simple – the Government would request the contractor to go after the employee's automobile insurance coverage to pay for the property damage. Even though the Government does not mandate that each and every employee carry automobile liability insurance, if such insurance does "in fact" exist – then the Government wants to be made whole.⁵ Paragraph (h)(3) clearly gives the government this right and option. It states, *"The Contractor shall do nothing to prejudice the Government's rights to recover against third parties for any loss, damage, destruction, or theft of Government property."*

These next two paragraphs are extremely important and extremely powerful.

Para. (h)(1)(ii) The loss, damage, destruction, or theft is the result of willful misconduct or lack of good faith on the part of the Contractor's managerial personnel. Contractor's managerial personnel, in this clause, means the Contractor's directors, officers, managers, superintendents, or equivalent representatives who have supervision or direction of all or substantially all of the Contractor's business; all or substantially all of the Contractor's operation at any one plant or separate location; or a separate and complete major industrial operation.

(iii) The Contracting Officer has, in writing, withdrawn the Government's assumption of risk for loss, damage, destruction, or theft, due to a determination under

⁴ Note that FAR Part 31.205 also discusses the issue of charging the Government for insurance as a Cost Principle.

⁵ See FAR 52.245-1 (h)(3)

paragraph (g) of this clause that the Contractor's property management practices are inadequate, and/or present an undue risk to the Government, and the Contractor failed to take timely corrective action. If the contractor can establish by clear and convincing evidence that the loss, damage, destruction, or theft of Government property occurred while the contractor had adequate property management practices or the loss, damage, destruction, or theft of Government property did not result from the contractor's failure to maintain adequate property management practices, the Contractor shall not be held liable."

These two items, (ii) and (iii), oft-times provide people with the most problems either because of preconceived ideas or through the way that they operationalize various definitions. Let us look at some of these terms and their respective definitions. What do we mean by "willful misconduct." There is no definition of "willful misconduct" in the FAR. We have to look at the DoD Manual for the Performance of Contract Property Administration, 4161.2-M (Hereafter referred to as the DoD Property Manual). The DoD Property Manual provides a simple definition. It states in the definitions section and in Chapter 2:

"Willful misconduct. Either a deliberate act or failure to act that causes, or results in, the Loss, Damage, or Destruction to Government property."

I believe that all of us can comprehend or envision a deliberate or intentional act. Taking a baseball bat and in anger smashing a car window is most definitely a deliberate act. A failure to act might be characterized as borrowing your next-door neighbor's gas lawnmower; being warned that it needs oil and then operating it without ever checking the oil. Keep in mind that these are very simplistic examples. We could go to Black's Law Dictionary and find numerous examples but again, we'll leave the law for later.

"Lack of good faith. Failure to honestly carry out a duty including gross neglect or disregard of the terms of the Government property clause or of appropriate directions from the Property administrator."

The DoD Property Manual and its definition of lack of good faith would appear to provide sufficient substance for us to determine what exactly would constitute an attribute under that definition. I won't address it further.

What I would like to do now is, in narrative form, present the infamous Drunken Fork Lift Operator Story. If you haven't seen it in person, I apologize - it loses something when presented in written form but I ask that you bear with me so I may make the necessary points to complete this analysis of liability.

At a large Contractor's facility a forklift operator shows up for work one morning in a decidedly drunken state. The foreman of the forklift operators sees this employee and recognizes this state of drunkenness due to previous company sponsored alcohol and drug related

awareness programs. Taking action, the foreman sends the employee to the locker room to change and go home. In the interim the Government's Property Administrator (PA) sees the foreman and they exchange pleasantries. The PA asks the foreman if the Government owned equipment scheduled to be shipped today is at the loading bay dock. The foreman remembers that it is not but assures the PA that it will be there shortly. The PA leaves - happy that he has done a good job. The foreman immediately rushes to the locker room, tells the forklift operator to return to work as the foreman needs a piece of equipment moved to the loading bay dock. "No problem" says the still drunk forklift operator as he quickly mounts his trusty forklift, loads that piece of equipment, proceeds to the loading bay dock at 50 miles per hour and upon reaching the loading bay dock launches the equipment into the air! Needless to say the equipment is destroyed. We will not talk about the drunken forklift operator - he escaped unscathed.

This is the question - Can the Government hold the contractor liable for the loss, damage or destruction of that Government Property?

Before you hastily answer, think about it carefully. Remember my original words in this paper – DO NOT THINK EMOTIONALLY!!! Analyze this issue from an intellectual standpoint – not one of anger!

Can the Government prove willful misconduct? We would probably all say yes. Can the Government prove lack of good faith? Again, we would all probably say yes.

Yet, in spite of this consensual agreement on these two items, the Government, cannot hold the contractor liable.

Why? Because we left out one critical factor. We must look at the clause again. FAR 52.245-1(h)(1)(ii) does state willful misconduct or lack of good faith, but on whose part? **CONTRACTOR'S MANAGERIAL PERSONNEL.** It is this definition that we must operationalize in our property administration and contract management environment. Not what we think it means but what it means in accordance with the FAR. We see the definition of Contractor's Managerial Personnel at 52.245-1(h)(1)(ii). It states,

"Contractor's managerial personnel, in this clause, means the Contractor's directors, officers, managers, superintendents, or equivalent representatives who have supervision or direction of all or substantially all of the Contractor's business; all or substantially all of the Contractor's operation at any one plant or separate location; or a separate and complete major industrial operation."

It is here that we see that management, contractor's managerial personnel, is not just someone who has the title of manager but must also have the authority, the legitimate power to control the entire company or corporation. To put it simply, plainly and clearly we

are talking about the Presidents, Vice Presidents, and the Directors of these companies. We must be very careful as to whom we apply this label of contractor managerial personnel. Some of you may still have some doubt in your mind as to whether this is correct. Well, the ASBCA comes running to our rescue again. In a landmark case, a seminal case for the field of Government Property, the ASBCA ruled on just this issue. In a case widely known as the Fairchild Hiller Case (ASBCA No. 14387. November 30, 1971) the contractor was tasked to perform inspection and repair of C-130 Aircraft. Unfortunately, a C-130 was destroyed by a fire caused by the usage of a highly flammable liquid in the cleaning process. The Air Force, having warned the contractor of numerous safety deficiencies, believed that there existed a "chasm between management actions and management assurances." Therefore, the Air Force attempted to hold the contractor liable.

The court, in reviewing the case, concluded that even though management might have been considered lax, they had not exhibited willful misconduct or lack of good faith and it was in fact negligence on the part of the operational personnel and mid-level management. Again, we must be concerned with the definition of managerial personnel. It is simply "Top Management." It would appear then that it is virtually impossible to prove "willful misconduct or lack of good faith on the part of contractor's managerial personnel" unless the president of a company TELLS us he or she is going to purposefully destroy an item of Government property and then sets about doing in front of us!

Well, maybe ... and maybe not. We must go one step further, one section on in paragraph (h) to(1)(iii) which states:

"The Contracting Officer has, in writing, withdrawn the Government's assumption of risk for loss, damage, destruction, or theft, due to a determination under paragraph (g) of this clause that the Contractor's property management practices are inadequate, and/or present an undue risk to the Government, and the Contractor failed to take timely corrective action. "

Note the steps and the conclusions in this section. The notification must be provided IN WRITING. It is interesting to note that in the past version of the FAR enormous attention was paid to the details regarding HOW this letter was to be sent and to WHOM this letter was to be sent. In the past version this letter was to be sent by certified mail – such is no longer a requirement – therefore, the Government loses its ability to “prove” the ultimate delivery of the notification. Secondly, there is no longer any direction as to WHOM the letter is to go to. Conceivably, it may go to the company property manager, most likely to the company contracts manager (Since that is the company representative with whom most Government COs deal). It is highly unlikely that it will go to contractor managerial personnel as defined in the clause as there is no contractual requirement to do so.

Lastly, this letter notifies the company of the Government's withdrawal of their assumption of risk for LDD&T due to a determination that the contractor's property management practices are inadequate and/or present an undue risk to the Government..

What does this provide the Government? The contractor is now **LIABLE** for all LDD&T. It would appear that the Government's withdrawal of its assumption of risk due to the inadequacy Contractor's property management system, though not meant to be punitive in nature, does serve as a very powerful and potent motivator. I am sure that if any of you have dealt with a Contractor whose system has been found to be inadequate, you know how quickly top management will start to pay attention to the area of Government Property. It is with this withdrawal of assumption of risk that the Contractor's liability essentially reverts to the "ALL" provisions of the previously discussed clause.

This action, the written notice of the Government's rescission of its assumption of risk makes the contractor liable for **ALL** loss, damage or destruction of Government property regardless of its cause. Upon receipt of the written notice of the Government withdrawing its assumption of risk -- the contractor is liable for ALL loss, damage or destruction of Government Property.

Ahhh, but in life there are always those "buts and excepts." It just so happens that this is the case with these liability provisions as well. Though the Government is presumed to have that "conclusive proof," there are available two, if I may call them such, escape mechanisms. The Government is not unreasonable and therefore realizes that there may be mitigating circumstances surrounding those losses of Government Property. If you notice, I did not complete all of paragraph (g)(1)(iii). I left off the portion that states:

"If the contractor can establish by clear and convincing evidence that the loss, damage, destruction, or theft of Government property occurred while the contractor had adequate property management practices or the loss, damage, destruction, or theft of Government property did not result from the contractor's failure to maintain adequate property management practices, the Contractor shall not be held liable."

Bear with me as I am going to discuss to two escape mechanisms in reverse order. The latter states:

"Occurred while the contractor had adequate property management practices...."

While previously the Government bore the responsibility to prove the contractor liable, for any LDD&T, that responsibility is now shifted to the Contractor to **PROVE** that it is NOT liable due to circumstances surrounding the LDD&T. In this case, when the loss actually occurred, i.e., the Time at which it occurred. When did the LDD&T occur? If the contractor can offer **clear and convincing evidence** that the incident occurred while an adequate system was in force, the Contractor may be granted relief of responsibility. The former, which is a little more complex, states:

"(A) Did not result from the Contractor's failure to maintain adequate property management practices...."

It is here that the Contractor may attempt to provide that clear and convincing evidence that there was no causal relationship between the LDD&T and the Contractor's

inadequate practices. Considering that a Contractor's PCS is evaluated in fifteen functions or processes, we have to consider which functions were unsatisfactory or deficient and remained uncorrected so as to lead to said determination of inadequacy. If the contractor can prove that there was no causal relationship, and let's use the legal word here -- no nexus, between the L,D & D and the reason for the Government withdrawal of its assumption of risk, the Contractor may again be granted relief of responsibility.

A simplistic example of this would be where a contractor is unsatisfactory or deficient in the category of subcontractor control. This deficiency leads to the contractor's PCS being determined to be inadequate. At some time after the letter by the CO a sub-contractor reports the loss of some Government owned Special Tooling (Note the actual loss occurred after the letter, not just the reporting of the loss). It would appear that **there is** a connection, a nexus, that causal relationship between the disapproval of the PCS and the loss. A second example would be if a contractor's PCS was rated inadequate due to deficiencies in all categories. All fifteen functions are unsatisfactory and the contractor refuses to take any action to correct them. The Government withdraws its assumption of risk due to this inadequacy. A commercial aircraft flying overhead crashes into the contractor's facility destroying all of the Government Property. The contractor could easily claim that there was no way having an adequate PCS would have prevented that plane from crashing. There was no relationship, no nexus between the plane crashing and the conditions leading to the Contractor's inadequate property management practices.

Notice that liability is a difficult but not impossible area to discuss.

Previously in the "old" versions of the FAR and its predecessor the Defense Acquisition Regulations (DAR) there were multiple version of liability: Liability under Fixed Price contracts, Liability under Fixed Price Negotiated contracts, Liability under Facilities contracts, and Liability under Cost Reimbursement contracts to name a few. But if we were to carefully analyze all of these clauses we could discover that ultimately there were two forms of liability – FULL risk of loss and LIMITED risk of loss.

LIMITED RISK OF LOSS 52.245-1	FULL RISK OF LOSS 52.245-1, ALTERNATE I
<p>USED WITH:</p> <ul style="list-style-type: none"> • Cost Reimbursement Contracts • Time and Material Contracts • Labor Hour Contracts • Negotiated Fixed Price Contracts where price is NOT based upon an exception at FAR 15.403-1 	<p>USED WITH:</p> <ul style="list-style-type: none"> • Fixed Price Contracts where price is based upon an exception at FAR 15.403-1, e.g., FAR Part 12 Contracts for commercial items
<p>Government assumes the risk of loss while a contractor maintains an adequate property management system and practices.</p> <ul style="list-style-type: none"> • Contractor may bear the risk of loss if their property management system and practices are deemed inadequate by the Property administrator and then the Government Contracting Officer notifies the contractor in writing that their property management system and practices are inadequate. • Contractor may have their liability for LDDT reversed if they can provide conclusive proof that the LDDT was not a result of the inadequate property management practices or where the LDDT occurred while an adequate system was maintained. 	<p>Contractor bears the risk of loss for ANY loss, damage, destruction or theft of Government property except for:</p> <ul style="list-style-type: none"> • Reasonable wear and tear or • reasonable consumption
<p>QUANTUM: When it is determined that the contractor is liable the government will assess the contractor in the amount of Intrinsic Value</p>	

WHY?

Why does the Government take this stand? Why not either hold the contractor liable for everything or have them carry insurance for everything? It has to do with one simple factor - COST. Under that fixed price contract whose price is based upon adequate competition, we, the Government, assume that this is the lowest price available. Therefore, even though this price may contain monies for insurance, it is the contractor's determination as to how much insurance to carry. It is the contractor's decision and responsibility to assume the risk. However, under the Fixed Price Negotiated and Cost Reimbursement type contracts this cost can be isolated and excluded from the contract price. More importantly, we, the Government, act as a self-insurer. Consider a hypothetical situation for a moment. Assume that the Government has \$100 billion worth

of Government Property in the hands of the contractors. A fairly accurate rough order of magnitude for the Department of Defense. If today insurance costs were running between 4 and 5% for a face value policy the Government, indirectly through all of its contracts, would be spending between 4 and 5 billion dollars a year for insurance.⁶ Instead they prohibit the contractor from carrying insurance and charging the Government for those costs and the Government acts as a self insurer - not spending that \$4 to 5 billion per year. Again hypothetically, if the contractors lost 1/2 of 1% of the Government Property in their possession in a year the loss would total \$500,000 million. This may appear to be mind boggling to us but consider that we are dealing with very large figures here. What is more important is a comparison and offset between what would have been spent for the insurance (\$4 to 5 billion) versus the loss (\$500,000 million) yielding a difference or savings of \$3.5 to \$4.5 billion dollars a year. If you think this is outlandish, consider for a moment that probably each and every one of you does the same thing every day. "What?" you say. "I wouldn't do something like that." Are you sure? If you own a car, you carry insurance on that car, hopefully. If you were to get into an accident, a fender bender, your insurance company would pay for the repair. The entire repair? Or is there something, some part of the repair price, they may not give you such as the deductible for 100 dollars or 250 or 500 dollars that you carry. What you are doing is acting as a partial self-insurer. The reason you do this is because it lowers your insurance premium. It is cheaper for you to carry that risk with the hope and the anticipation that you WILL be careful and that you WILL NOT have an accident. The Government takes the same position. They believe that the Contractor WILL be careful and that they WILL NOT lose, damage or destroy any Government Property. It is a logical thought process.

CONTRACTOR PROPERTY MANAGER RESPONSIBILITIES

The contractor's responsibility for reporting LDD&T of Government property is not found in the liability provisions of the clause but rather is found in the "Process" portion of the clause that discusses the requirements for the contractor plans and systems – paragraph (f) of 52.245-1. Under paragraph (f)(1)(vi) entitled reports paragraphs (A) and (B) provide the contractor guidance regarding the reporting of LDD&T. Paragraph (A) states,

"Loss, damage, destruction, and theft. Unless otherwise directed by the Property Administrator, the Contractor shall investigate and promptly furnish to the Property Administrator, a written narrative of all incidents of loss, damage, destruction, or theft, as soon as the facts become known or when requested by the Government."

Quite simply contractors are required to report all incidents of LDD&T unless the PA through the contractor's property management system and practices has agreed to another process, e.g., compiling LDD&Ts for periodic reporting where individual reporting would be prohibitively expensive – such as normal low rate losses of material.

⁶ Please note that the 4-5% figure has increased dramatically since the occurrence of 9-11. As such the Government savings as a self insurer undoubtedly would have increased.

What information is required to be reported? Paragraph (B) requires,

“(B) Such reports shall, at a minimum, contain the following information:

- (1) Date of incident (if known).*
- (2) The name, commercial description, manufacturer, model number, and National Stock Number (if applicable).*
- (3) Quantity.*
- (4) Unique Item Identifier (if available).*
- (5) Accountable Contract number.*
- (6) A statement indicating current or future need.*
- (7) Acquisition cost, or if applicable, estimated scrap proceeds, estimated repair or replacement costs.*
- (8) All known interests in commingled property of which the Government property is a part.*
- (9) Cause and corrective action taken or to be taken to prevent recurrence.*
- (10) A statement that the Government will receive any reimbursement covering the loss, damage, destruction, or theft, in the event the Contractor was or will be reimbursed or compensated.*
- (11) Copies of all supporting documentation.*
- [(12) Last known location.*
- (13) A statement that the property did or did not contain sensitive or hazardous material, and if so, that the appropriate agencies were notified.”*

Taking this information it is now in the PA's hands to reach a valid and supportable conclusion using their knowledge of the policy and clausal liability requirements, analyzing the Contractor provided information, as well as performing their own investigation.

GOVERNMENT PROPERTY ADMINISTRATOR RESPONSIBILITIES

The Government PAs take their lead in processing the report of L,D, & D from the DoD Property Manual, Chapter 2, Section E.4 entitled Liability for **Loss, Damage, Destruction or Theft of Government Property**. Paragraph (d) states:

“It is the PA's responsibility to investigate the circumstances of LD&D of Government property and review the risk of loss and other contract provisions to determine which party assumes the risk of loss. When the Government assumes the risk of loss, investigations, in some circumstances, may be limited to verifying whether the contractor's report of LD&D is accurate. Extensive investigations should only be performed when dollar amounts, nature of the property, and circumstances of the incident warrant it. The assistance of other CAO technical personnel should be requested when appropriate.”

There should be no room for feelings as this area is far too critical to be based upon anything other than the known facts of the occurrence. As some instances of L,D, & D may involve highly technical aspects, it would behoove the PA to consult with other technical and legal specialists. We as PAs must not lose sight of the team alignment of

the Contract Management Function.

“c. Risk of Loss Assumed by the Government. If authorized through the PA's Certificate of Appointment the PA may take direct action as described below if the Government has assumed the risk of loss. The contractor must identify the circumstances that led to the incident, and the provisions under the contract through which risk of loss was assumed. If the PA determines that the LD&D of Government property constitutes a risk assumed by the Government, the PA shall notify the contractor in writing, that the risk of loss is the responsibility of the Government. A copy of the documentation and notification to the contractor shall be retained in the Contract Property Control Data File for the contract. An informational copy shall be provided to the CO. Additional reporting may be prescribed by agencies.”

Here is where we see one of the Government PA's authorities. Though the Government PA has many tasks to perform, many of them are responsibilities connoting no authority. This task, granting relief of responsibility, is an authority that comes from their Certificate of Appointment delineating their authorities granted by the Contract Administration Office.

If the PA determines that this loss cannot be presumed to be one of those that we said the contractor SHALL be liable for under either FAR 52.245-1 (h) Contractor Liability for Government Property, or FAR 52.245-1 Alternate I (h) Risk of Loss , the PA shall grant the contractor relief of responsibility and so notify the contractor.

It is important to note that the PA does **NOT** have the authority to **HOLD** the contractor liable. That is an action reserved for the Contracting Officer, more specifically, the Administrative Contracting Officer (ACO). The DoD Property Manual Chapter 4.E states:

"If the property administrator concludes that the contractor should be liable for the loss, damage, destruction, or unreasonable consumption of Government property, he shall forward the complete file with his conclusions and recommendations to the administrative contracting officer for review and determination...."

It is the ACO's responsibility to review the file on this liability action and make a final determination. As the ACO is responsible for the financial well being of a contractor, and the holding of a contractor liable may affect the contractor financially, this would appear to be a prudent posture for the government to take. In addition, the ACO would be the only one who could withhold funds from the contractor if this were the methods utilized to recover the cost of the lost, damaged or destroyed Government Property. Once a decision is made the ACO will act in accordance with the DoD Property Manual, Chapter 2.E.6 which states:

A copy of the CO's determination shall be furnished to the contractor, to the PA, and a copy shall be retained in the files of the CO. The PA's copy shall be filed in the Contract Property Control Data File for the contract when all pertinent actions, such as compensation to the Government or repair or replacement of the property, have been completed. In the event that the contractor acknowledges

liability, the PA will notify the CO in writing requesting a decision as to course of action required for equitable settlement.

Summary

The risk of loss provisions for Government property in the possession of contractors have stood the test of time in their application, economy and efficiency. I do not need to tell you that the issue of liability and the actions required to report, support and resolve any instance of Loss, Damage or Destruction of Government Property are complex and lengthy. Philosophically, one could not be faulted for saying something as patronizing and pedantic as it is in the Contractor's best interest to control and protect Government Property in such a manner so as to preclude any of the above from happening.

Unfortunately, or fortunately, whichever the case may be, we are human beings who have accidents and damage things, who slip up and lose things and who, through mishaps, destroy things. The Government is not unreasonable in its demands that a contractor properly care and protect its property. One would hope that we may all see this through the application of the various risk of loss provisions. It does make it incumbent upon us, both Government and Contractor personnel, to strive for that degree of protection where any form of loss, damage or destruction to the Government's assets are minimized. We, as Property Administrators, must show this concern for Property both within the Government as well as within the Contractor world to exhibit our belief in our Profession - the Profession of Property Management!