

# TERMINATIONS AFTER WORLD WAR I\*

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In the determination of effective policies and procedures for the termination and settlement of war contracts at the cessation of hostilities, nothing would be more foolhardy than a failure to profit from our experience with this problem after the first World War. We cannot afford to repeat mistakes made the last time; nor can we ignore policies and procedures which proved successful.

To be sure, the situation which prevailed after World War I differs in certain respects from that which is likely to obtain after the present war. Most important is the fact that the magnitude of the contract termination and settlement problem was much smaller than it will be this time. As contrasted with the 50 to 100 billion dollars of cancellations anticipated after this war there were only about 8 billion dollars of cancelled contracts after World War I. The number of contracts involved, and the number of companies and wage earners affected was also considerably smaller. The volume of industrial conversion completed at the time of the Armistice was relatively small, and the burden of reconversion was correspondingly light. As a consequence of these contrasts in magnitude the whole issue of speed in the settlement of contract claims was definitely less important than it is likely to be this time.

In addition, some of the technical problems likely to militate against rapid settlement of war contracts this time were not present in World War I. Outstanding among these is the Government's present obligation to remunerate manufacturers for "anticipated profits," *i.e.*, profits that would have been earned if the contract had been completed. During the last war, as we shall see, the Government denied

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its responsibility for these profits, thereby obviating difficult problems of calculation.

On the other hand, progress has been made in certain directions which should help us to avoid some of the confusion and delay we experienced the last time. Government contract procedures are much more standardized. Termination and settlement clauses are much more explicit. Advance preparation of accounting records by contractors, allowing for rapid determination of amounts due, has been encouraged; and, most important, there has been a much earlier and more widespread appreciation of the importance of the problem.

In spite of these points of contrast, the fundamental issues and problems in the termination and settlement of war contract claims are sufficiently comparable as between the two situations to justify a careful scrutiny of our experience after World War I. Such is the task of this article.

#### THE PROCUREMENT PROGRAM AND THE ECONOMIC SCENE AT THE TIME OF THE ARMISTICE

Underlying the termination problem at the close of the first World War, and basic to an understanding of both the Government's and industry's approach to that problem, were the developments in Government procurement of war material during the eighteen months in which the United States participated in the hostilities. In April 1917, when the United States became a participant in hostilities, industry was already surfeited with orders. Months earlier, the Allied Governments severally had established buying missions in the United States. When they came, they found few industrial plants prepared to manufacture war goods. By offering contracts at attractive prices, they persuaded businessmen to erect plants, train personnel, and undertake production of munitions. Indeed, some entrepreneurs organized entirely new companies in order to secure and fulfill these contracts. The heavy industries, which had been on the edge of a depression when war was declared in Europe, became increasingly active; and industrial workers, who had faced unemployment, secured steady jobs and relatively high wages.

Nor was this development confined to the heavy producers goods industries, for the Allied buying missions also purchased large quantities of food and clothing. Exports of breadstuffs, for example, increased in value from 310 billion dollars in 1914 to 472 billions in 1916; exports of meat, from 138 millions to 279 millions; and exports of manufactures of cotton from 50 millions to 129 millions.

Secondary repercussions upon the economy were soon evident. Industrial workers with steady incomes purchased larger quantities and better qualities of food. These and other factors contributed to prosperity for agriculture. Prosperous munitions workers and farmers, together afforded an active market for consumers' goods. Manufacturers of these goods were stimulated by this new demand to higher levels of production. By April 1917, therefore, the manufacturing capacity of the nation was largely occupied, and supplies of raw materials, finished products, and labor were becoming increasingly scarce.

The war demands of the United States after April 1917, were imposed upon this saturated market. While some preliminary work on ways to fill possible war requirements had been begun by the Council of National Defense the initial attempts were somewhat disappointing. At first, emphasis was placed upon securing the needed output of war goods without restrictions on production or the flow of required materials. Congress authorized the President to allow the heads of buying agencies to forego the usual competitive bid method of letting Government contracts, and to negotiate directly with manufacturers.<sup>1</sup> This measure, by itself, however, could not do the job. Chaotic competition between the Allied buying missions and the United States, as well as between different procurement agencies charged with the purchasing of similar items, ensued. The result was a sharp rise in the prices of military goods without an adequate increase in production.

Gradually the Government undertook to channelize productive activity into war work. Restrictive regulations were imposed upon industry by the War Industries Board, the Food Administration, the Fuel Administration and other war agencies. The first of these, the War Industries Board, was especially active. It directed supplies of materials to war uses through priority and allocation regulations, and prevented wasteful use of scarce raw materials by conservation and curtailment orders.

Although dwarfed by the astronomical size of our present production program the procurement activity of World War I was of major proportions. The War Department contracted for at least 22 and possibly more than 24 billion dollars worth of munitions between April 1917 and November 1918; the Navy for about 3 billions in the same period; and the Emergency Fleet Corporation (World War I equivalent of the Maritime Commission) for another 3 billion dollars. Less impressive, but still large purchasers, were the Grain Corporation and the Sugar Equalization Board. Especially significant is the rapid rate of growth of the procurement program. Contracts let by the Ordnance Department of the War Department, for example, totalling about 1.5 billion dollars as of December 1917, had increased to about 6.5 billion dollars by November 1918. In both the War and the Navy Departments, procurement in 1918 more than doubled that of 1917.

Only scattered bits of information as to the number of contractors involved in production under these contracts are available. Under its steel ship program alone, the Emergency Fleet Corporation dealt with approximately sixty shipyards scattered along both coasts, the Gulf of Mexico and the Great Lakes.<sup>2</sup> It is reasonable to estimate War Department contractors as numbering at least 50,000.

As is true at the present time, a vast number of subcontractors and materialmen provided the holders of war contracts with raw materials, component parts

<sup>1</sup> On the day war was declared the President transmitted this authority to the War and Navy Departments.

<sup>2</sup> REPORT OF DIRECTOR GENERAL CHARLES PIEZ TO THE BOARD OF TRUSTEES OF UNITED STATES SHIPPING BOARD, EMERGENCY FLEET CORPORATION (1919), Exhibit 4.

and other services. While no specific statistics are available, we have the statement of the Secretary of the Council of National Defense that "the end of the war found the United States as complete a military machine throughout its whole industrial and economic life as the world has ever seen."<sup>3</sup>

The economic implications of this procurement program, while obviously less extensive, were not unlike those which we have witnessed this time. Some conversion of industrial plant was necessary. When the United States entered the war less than twenty companies were engaged in the manufacture of ordnance supplies, and they were all occupied with contracts from the Allied Governments.<sup>4</sup> The Ordnance Department had to engage the services of many more manufacturers. It turned to the so-called heavy industries. Locomotive works were given contracts for the largest tanks; automobile firms received contracts for light tanks, machine guns, and airplane parts; similar changes were required to a lesser extent of farm machinery manufactures, foundries, and engine works. Other manufacturers possessed equipment immediately adaptable to war production. Rug makers, for example, turned to the production of heavy cotton duck, blankets and certain machine gun parts with little change in their existing equipment.

In the last war the bulk of war manufacturers were located in the northeastern section of the United States. Especial concentrations existed in Massachusetts, New York, Pennsylvania, Connecticut, New Jersey, and Ohio. Manufacturers in these six states, together with those in Illinois, Wisconsin, Michigan, and Indiana, received 90% of all War Department contracts let in 1918. The ship building programs of the Navy and the Emergency Fleet Corporation, of course, stimulated activities in all of the coast states as well as those along the Gulf of Mexico and the Great Lakes. Not until late 1918 was any concerted effort made to spread contracts geographically so as to stimulate industry in the South and the central West.

This concentration of war production in a few states, together with the curtailment of production of civilian goods tended to draw new workers from other sections to the war production centers. Bridgeport, Connecticut, for example, swelled in population to about four times its pre-war size. Boom conditions affected other cities like New Haven and Lawrence, Connecticut; Buffalo and Kingsport, New York; Brunswick, Georgia; Gary, Indiana; Cleveland and Dayton, Ohio; Bay City and Detroit, Michigan; Oakland, California;—to name just a few. In some instances, new cities sprang up around newly constructed war plants, such as the bag-loading plant at Nitro, West Virginia. These developments gave rise to problems of labor pirateering, wage rate adjustments, and housing conditions, all of which have become sadly familiar during the present war production program.

In the fall of 1918 the war effort was driving toward its climax. The procurement programs of the War and Navy Departments were geared to an all out offensive for the Spring of 1919, when the Expeditionary Force in Europe was

<sup>3</sup> GROSVENOR B. CLARKSON, *INDUSTRIAL AMERICA IN THE WORLD WAR* (1923) 9.

<sup>4</sup> REPORT OF CHIEF OF ORDNANCE, 1918.

expected to number five million men. The regulations of the various war agencies affecting industry and labor became increasingly strict in an effort to divert the maximum possible production to the most critical war needs. With the attention of the nation focussed on war, little time or thought was directed toward the problems that might be brought on by peace.

Suddenly the enemy forces began to disintegrate. Late in October 1918, Bulgaria sued for peace. On November 8, 1918 the "false" Armistice thrilled the nation. On November 11, hostilities ceased.

At this time, the War Department had more than 30,000 contracts outstanding. The Navy and Emergency Fleet Corporation shipbuilding programs were just coming to maturity. Few ships had been produced under this latter agency, but now when peace had come the many building ways constructed under war contracts were laden with partially completed vessels. Billions of dollars worth of goods—about nine billions under the War Department contracts alone—were called for by outstanding war contracts.

But the World War was fought as the "war to end all wars." Munitions would, therefore, have little or no value in the future. The country could ill afford to allow costly raw materials to be processed into worthless war goods. Yet, while the advance of our armed forces could be brought to a halt with a single command, terminating the huge production program behind these forces was far more difficult. The cancellation of war contracts, and the settlement of the resulting financial claims, gave rise to legal, administrative, and economic problems, inherently complex, and often involving conflicting objectives of public policy.

#### LEGAL BASES OF TERMINATION

An initial complication arose from the lack of a single uniform legal basis upon which the right of the Government to cancel war contracts and determine its ensuing financial liability could be predicated. War contracts fell into three principal groups: viz. (1) those containing specific termination clauses, reserving the Government's power to cancel under certain contingencies, and setting forth, in various degrees of detail, its liabilities in the event this contractual prerogative was exercised; (2) those falling into classes of war contracts in which statutes specifically vested the power to terminate and settle under certain conditions in offices of the Government; and (3) those in which there was neither specific contractual nor statutory authorization for termination.

The widespread use of a standard termination clause might have facilitated the termination and settlement process. The basis of settlement would have been known in advance. Contractors could have maintained suitable records, readily accessible at the crucial time; and the Government could have planned beforehand for uniform and speedy administration. Unfortunately, however, the virtues of a standard termination clause were not appreciated until September of 1918, too late for it to have served as a basis for the establishment of general termination and settlement policy.

Contracts in use when the war began contained only termination clauses providing for cancellation in the event of breach by the manufacturer. Soon after the United States entered the war, the Ordnance Department began experimenting with a simple termination provision. This clause merely authorized the Chief of Ordnance to cancel the contract if the war ended or if he anticipated the war's end. It was silent as to the basis of settlement.

From this simple beginning the Ordnance Department began elaborating and refining its termination clause. By early 1918 the clause used in Ordnance contracts provided that:

(a) the Government would pay the full contract price for all articles on hand at the time of termination as well as those completed within thirty days after the serving of the termination notice.

(b) the Government would reimburse the contractor (1) for the cost of raw materials and component parts in possession of the contractor but not exceeding the requirements of the contract; and (2) for all costs necessarily incurred for the performance of the contract and remaining unpaid at the time of cancellation.

(c) to the above, the Government would add "such sums as the Chief of Ordnance may deem necessary to fairly and justly compensate" the manufacturer for services rendered.

(d) the Government would protect the contractor on all obligations (to sub-contractors, materialmen, etc.) solely and necessarily incurred for the performance of the contract.

(e) title to materials and articles paid for by the Government would immediately, upon payment by the Government, vest in the United States.

This clause, while it left much to be desired, represented a step in the right direction; but the example set by the Ordnance Department was not widely followed by the other procurement agencies of the Government. In many cases the standard contract in use made no mention of cancellation. In others the simplest provisions (usually merely authorizing cancellation "in the public interest") were employed. In still others various versions of the earlier Ordnance Department cancellation provisions were in use.

In the summer of 1918 the advantages of a uniform standard termination clause began to be recognized. The Purchase Storage and Traffic Division, the procurement policy-making agency within the War Department, set itself to the task of developing such a clause for use by all of the supply bureaus. The clause developed was adopted in September of 1918<sup>5</sup> and represented the most detailed cancellation provision in use during the war. Some of its salient provisions are worthy of consideration.

As was true in the case of most cancellation clauses in use during the last war this clause provided for a certain period of continued production after notice of

<sup>5</sup> Supply Circular No. 88, War Department, Purchase, Storage and Traffic Division, General Staff, September 7, 1918.

termination<sup>6</sup> in order to allow the contractor to complete a substantial amount of the goods in process. The contractor's compensation after termination was to consist of the following elements: (1) the contract price for articles completed, and for which reimbursement had not as yet been made; (2) such proportion of the expenditures<sup>7</sup> made in connection with the contract as could be apportioned to the terminated work; (3) a certain percentage of the amount ascertained under (2); and (4) that part of the difference between the "fair market value" of the plant and facilities obtained for the performance of the contract and the cost to the contractor of these facilities as could be apportioned to the terminated part of the contract. Questions of fact, other than appraising the "fair market value" of facilities, were to be determined by agreement between the contractor and the contracting officer. Disagreements, as well as the appraisal of the facilities were to be settled by a committee of three persons, one to be appointed by the contractor, one by the contracting officers, and the third by these two.

Very significantly this clause recognized the dangers inherent in forcing the small subcontractors to wait for payment until the time consuming settlement of the prime contractor's claims had been made. Consequently it provided that at the request of the contracting officer all subcontracts of the prime contractor were to be assigned to the Government.

This clause, however, was not adopted for general use until September 1918—so late in the war that it merely added another statement to the confusion of clauses then in existence. While General Goethals, as Director of Purchase, Storage and Traffic could say after the Armistice that most contracts then in force contained termination provisions<sup>8</sup> he could not point to any one clause and safely say it was typical of the clauses then in force. The potential advantages of a standard termination clause in providing the basis for the establishment of a smoothly functioning administrative mechanism were never realized in World War I.

The second legal basis for the termination and settlement of war contracts, specific statutory authority to terminate, had only a limited application and was confined to Navy Department and Emergency Fleet Corporation contracts.

Even before the war began the President, in a Navy Department appropriations act<sup>9</sup> was authorized to "modify or cancel any existing contract for the building, production, or purchase of ships or war material" and directed to make "just compensation" therefore. The act further provided that if the amount of compensation determined by the President was unsatisfactory to the contractor the latter was entitled to receive 50% of the amount determined by the President, and

<sup>6</sup> This was usually 30 days, although some of the clauses permitted as much as 90 days continued production.

<sup>7</sup> Other than expenditure for plant facilities and equipment solely provided for the contract. Any raw materials, goods in process etc., for which the contractor was reimbursed were to become the property of the United States.

<sup>8</sup> Testimony of Gen. George W. Goethals in *Hearings on War Contracts before House Select Committee on Expenditures in the War Department* (1919).

<sup>9</sup> 39 STAT. 1193, Pub. L. No. 391 (March 15, 1917).

could sue the United States<sup>10</sup> to recover whatever added to this 50% would equal a "just compensation." These provisions were reenacted in similar, though somewhat broader, terms after our entry into the war.<sup>11</sup> This later enactment, however, increased the 50% payment provision to 75% of the amount determined by the President. The President's powers under this legislation were subsequently delegated to the Secretary of the Navy<sup>12</sup> and the Emergency Fleet Corporation.<sup>13</sup>

While restricted in its application, this statutory basis of settlement was nonetheless important. It involved some of the largest and most important of World War I contracts. It also gave rise to some of the most difficult legal issues (especially the interpretation of "just compensation") placed before the courts as a result of the termination of war contracts. These problems, however, may be more profitably considered in the analysis of the judicial settlement of contracts presented below.<sup>14</sup>

Where war contracts contained no termination provision or did not fall within the terms of the Act of June 15, 1917 the Government was forced to base the cancellation and settlement of war contracts on certain principles of general law by no means well established at the time of the Armistice. The central question at issue was most succinctly stated by one writer as follows:<sup>15</sup> "Does the fact that these contracts were made because of and in aid of war give the Government any more latitude in abrogating them than it would have in regard to a contract made in time of peace and for peace purposes?" In the light of principles promulgated by the courts before 1918, arguments and judicial authority supporting either an affirmative or a negative answer to this query could be mustered.

There was little difficulty in establishing the authority of the Government to terminate these contracts. A leading case, many years before the war,<sup>16</sup> had held that the statutory authority of the Secretary of the Navy to contract for the procurement of naval stores necessarily implies the power to suspend and settle such contracts when from any cause the public interest so requires. This principle was logically applicable to the National Defense Act,<sup>17</sup> the basic enabling legislation for all World War I procurement.

Much more controversial was the question of the measure of damages in cases of cancellation not specifically authorized by contract or statute. On the one hand courts on numerous occasions had pointed out that the United States loses its sovereign character when it enters into a contract with a private individual and is

<sup>10</sup> In the manner provided for in sec. 24 and sec. 145 of the Judicial Code.

<sup>11</sup> 40 STAT. 182, Pub. L. No. 23 (June 15, 1917).

<sup>12</sup> EXEC. ORDER of Aug. 21, 1917.

<sup>13</sup> EXEC. ORDERS of July 11, 1917 and Dec. 3, 1918.

<sup>14</sup> Also left for later consideration are cancellations and settlements under the Dent Act. *Infra*.

<sup>15</sup> 22 LAW NOTES 167 (1918).

<sup>16</sup> *United States v. Corliss Steam-Engine Co.* 91 U. S. 321 (1875).

<sup>17</sup> 39 STAT. 166, Pub. L. No. 85 (June 3, 1916). This act provided that "The President, in time of war or when war is imminent, is empowered through the head of any department of Government, in addition to the present authorized methods of purchase or procurement, to place an order with any individual . . . for any such material or product as may be required."

liable for breach of contract in the same measure of damages as private individuals, namely the difference between the contract price and the cost of completing the contract.<sup>18</sup> It had further been held in one case that the suspending of a contract by the Government due to the exigencies of war was nonetheless an improper interference with the contract, and that the Government is not exempt from ordinary contractor's liability because it suspends the contractor's work from motives of public interest.<sup>19</sup> The court argued<sup>20</sup> that "while from patriotic motives every citizen, for the mutual good of all others, should be held to such reasonable sacrifice of personal interests as may be necessary for the public welfare, the rule should not be held to impose unjust or unequal burdens."<sup>21</sup>

On the other hand, the right of the Government to cancel war contracts containing no termination provisions without liability for breach could be based on at least two distinct grounds. In the first place, it could be argued that the very nature of wartime procurement placed an implicit limitation upon the extent to which Government officers were authorized to bind the Government. The fundamental right of the Government to acquire property necessary to the proper administration of its functions is inherently limited to the acquisition of property actually required for public use. Agents of the Government procuring war material could only bind the United States for production until the necessity for that production had ceased. As such the Government had a right—whether expressed in the contract or not—to cancel war contracts when the necessity for further production had ceased, and that without ordinary liability in damages for breach.<sup>22</sup>

A like result could be reached on another ground. War contracts could be viewed as containing an implied condition that the contract would be abrogated when the need for the articles contracted for ceased. This would be an application of the doctrine of "frustration of purpose" first established in the *Krell* case in England<sup>23</sup> and often employed in admiralty law. It could be contended that any person entering into a contract with the Government for the production of military items must have recognized the fact that with the ending of hostilities the need for these goods would cease. The implied condition could therefore be read into all contracts containing no termination clauses, and the Government excused from liability for breach.<sup>24</sup>

<sup>18</sup> *United States v. State Bank*, 96 U. S. 30 (1877); *United States v. Speed*, 8 Wall. 77 (U. S., 1868); *United States v. Smith*, 94 U. S. 214 (1876).

<sup>19</sup> *The Houston Construction Company v. United States*, 38 Ct. Cl. 724 (1903).

<sup>20</sup> *Id.* at 736.

<sup>21</sup> As in the case of private contracts, however, the general rule of minimizing damages applies where the Government is held liable for breach of contract. *Yates v. United States*, 15 Ct. Cl. 119 (1879).

<sup>22</sup> An excellent exposition of this view is presented in T. M. BIGGER, *The Right of the Government to Cancel and Terminate Contracts for the Continuous Production of War Materials When the Necessity for Such Production Ceased*, National Archives, Department of Justice Archives, War Transaction Section, File No. 282.

<sup>23</sup> *Krell v. Henry* [1904] A. C. 565.

<sup>24</sup> This position is set forth in T. A. REYNOLDS, *Doctrine of Frustration of Purpose As Applied to Contracts Made by the United States During the Late War*, National Archives, Department of Justice Archives, War Transaction Section, File No. 279. [For a recent discussion of "frustration" and other

## ECONOMIC POLICY ISSUES

Unfortunately, questions of the legal basis for contract termination and the elements of compensation loomed disproportionately large in the preparations for the establishment of basic termination and settlement policy in World War I. The paucity of discussion indicates that there was an amazingly meagre and narrow recognition of the fact that the termination of war contracts had important economic implications. A few economists, however, largely Government employees, wrote inter-office memoranda pointing out a few critical factors bearing upon the problem. All of their suggestions predicated the public interest. At the same time, most of them can be segregated as emphasizing industry problems or stressing labor's plight.

The primary problem facing industry was the task of returning to peace-time production as expeditiously and with as little damage to financial structures as possible. But war production, even of the relatively limited scope of World War I, involves a tremendous variety of industries, and a host of vastly different problems of readjustment. Simple justice demanded that war contractors be accorded treatment more or less in keeping with their specific problems. This was not an easy task.

The central issue was the rate of contract cancellation, i.e. whether production under war contracts was to be abruptly terminated or gradually tapered. Arguments in support of both policies were advanced. It was contended, on the one hand, that tapered production would allow producers of specialized war goods time to adjust their processes to peace-time products, avoiding the consequences of complete shutdowns during the period that contract settlements were being negotiated. Proponents of tapered termination urged that, as a minimum, cancellations should allow the completion of goods in process, for readjustment and reconversion would be seriously hampered, from a financial as well as a physical point of view, if contract cancellations left partially completed items on the production lines for any length of time. This view was further supported by the argument that since many partially finished products had only scrap value it was to the public interest to allow completion of goods upon which work had already begun at the time of cancellation.<sup>25</sup>

On the other hand it was urged that tapered termination of war contracts involved an unconscionable waste of scarce resources; and that in any event it was unnecessary in the case of producers of goods having peace-time uses who could immediately begin production for civilian use.<sup>26</sup>

Fallacies in the contentions advanced in support of both sides of this issue are apparent. The economic cost of continuing to use valuable raw materials in the

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pertinent doctrines, see Schroeder, *The Impact of the War on Private Contracts* (1944) 42 MICH. L. REV., 603. Editor.]

<sup>25</sup> National Archives, Records of the War Industries Board, File 21A-A4, folder "Contracts, Cancellations—War Department."

<sup>26</sup> *Id.* folder "Contract Cancellations," 728.

production of useless specialized war goods would most likely outweigh the advantages of maintaining continuous production. Continued production of these war goods would merely have delayed the inevitable problems of reconversion; it would have been an expensive and ineffective substitute for a well planned program to speed contract settlement and to avoid the financial consequences of unavoidable delays. On the other hand some form of tapered termination might have proved effective in the case of contracts for goods which had a direct or easily convertible peace-time use. To argue against such a policy on the grounds that producers of such items could immediately begin manufacture for civilian use is to ignore the fact that the producer's problem of transition from war to peace was often as much a problem of quickly reestablishing his peace-time markets as it was a problem of reconverting his plant.

Nonetheless, the position finally adopted by the War Department reflected the influence of both points of view outlined above. It first cancelled contracts for goods having a peace-time value and encouraged tapering of production for purely military items.

From the point of view of labor the central problem was to minimize disemployment resulting from the termination of war contracts. Employment opportunity was certain to be restricted by the sudden cessation of war production. Millions of workers in war industry would be deprived of employment. They would compete with returning servicemen for the jobs available in peace-time industry. Furthermore, since the wartime shortage of labor would be relieved, and supply more nearly balance demand for workers, it was probable that overtime would come to an end. This would sharply reduce weekly paychecks. Moreover, since war industries were noted for their high wage levels, it was probable that workers going to other industries would receive lower base wage rates. Widespread unemployment, with job opportunity available only in those industries paying lower wages would, it was feared, encourage development of a radical labor group.<sup>27</sup> Cancellation policy, therefore, should be devised to reduce the effects upon employment, to minimize the hardships to war workers.<sup>28</sup>

In order to reconcile the public interest in stopping the processing of costly raw materials into worthless munitions, it was suggested that contracts should be canceled at once and labor protected from widespread distress by establishing an "unemployment benefit fund" from funds the contractor would have spent for wages had their contracts been completed. The proposed application of this plan had marked similarity to the present Unemployment Insurance arrangement. Workers laid off would report to the local office of the United States Employment Service and register for employment in their trade. While unemployed they would draw from one-half to two-thirds of the average wages earned while employed on war

<sup>27</sup> National Archives, Division of Labor' Department Archives, Files of the War Labor Policies Board, folder "Employment Service—Freund."

<sup>28</sup> *Id.*, folder "Employment Service—Croston" and "War Department—November."

contracts. This reduction in wage, while preventing undue hardship, would encourage workers to seek employment in civilian work.<sup>29</sup>

These were some of the suggestions that bore on economic policies. Most of them, unfortunately, were not prepared until after the Armistice. Few of them had the chance to be seriously considered by the agencies faced with administration of cancellations. None of them had the opportunity to be publicized and discussed with industry or labor, the two groups most directly affected by cancellation.

#### TERMINATION AND SETTLEMENT IN PRACTICE<sup>30</sup>

The foregoing discussion has centered upon the legal bases of termination and the economic policy issues noted during and after World War I as bearing upon termination. We turn now to the application of these bases and policies in the termination of World War I contracts, and the settlement of resulting claims. Since the magnitude and importance of the War Department problem far outshadowed that of the other procurement agencies the discussion is, in the main, confined to the termination and settlement of War Department contracts.

The program for cancelling War Department contracts was announced in two supply circulars issued two days before the Armistice by the Purchase, Storage and Traffic Division of the General Staff. The first of these<sup>31</sup> delegated responsibility for selecting the contracts to be cancelled to the procurement officers in the supply bureaus. When they decided upon cancellation, contracts containing termination clauses were to be cancelled in accordance with the terms set forth therein; manufacturers holding contracts without such clauses were to be requested to suspend war production within thirty days. In practice, nearly all contractors who refused to accept negotiated claim settlements received termination notices.

The second circular<sup>32</sup> modified the cancellation authority given to procurement officers. Before a contract could be cancelled, cancellation proposals had to be drawn up for approval by the Purchase, Storage and Traffic Division. Before the latter would give its approval, it would seek the "advice and assistance of the War Industries Board." The cancellation proposals would be forwarded by the External Relations Branch of the Division to the appropriate commodity section of the Board which would "forthwith either approve the reduction recommended by the procuring bureau or modify the proposed reduction." Note of the commodity section's action was to be returned to the External Relations Branch which in turn would advise the supply bureaus of the approval or modification. Except in cases of modification, the supply bureau was expected immediately to proceed with cancellation. The circular excused the supply bureaus from compliance with the

<sup>29</sup> *Id.*, folder, "Cancellation of Contracts." It is not clear by what method the contractor would be reimbursed. Presumably he could recover the sums as part of the cost of cancellation. Other proposals suggested a specific congressional appropriation of funds for unemployment relief. See folder cited *supra* note 26.

<sup>30</sup> This section is based primarily upon unpublished documents located in the National Archives, Division of the War Department Archives.

<sup>31</sup> War Department, Purchase, Storage and Traffic Division, Supply Circular No. 111 (1918).

<sup>32</sup> *Id.* Supply Circular No. 112 (1918).

above procedure in three kinds of situations, namely: (a) if the contract had been negotiated after October 1, 1918; (b) if the production cancelled under the contract amounted to less than \$100,000; and (c) if cancellation applied to all of the contracts for a particular product.

The Armistice came before the procurement officers were advised of these supply circulars. It also came before the War Industries Board could express its reaction to the procedure as set forth.

On November 11, the cancellation machinery was put into action. On November 12, the first cancellations were ordered. On that day too, the War Industries Board for the first time indicated its attitude toward the announced War Department policy. In a memorandum to all section chiefs, the Acting Vice Chairman of the Board stated: "It is not proposed that the War Industries Board participate in negotiations or share in the responsibilities for the details of the financial adjustment with contractors in such matters as the disposition of raw materials on hand, damages, depreciation, etc. . . ."

The policy announced by the Vice Chairman did not appeal to the commodity section chiefs, most of whom had been drawn from and planned to return to industrial positions. They were in daily contact with the representatives of industry—the "War Service Committees" of leading industrialists which had acted as liaison between the Board and industry, the trade associations, and individual companies. Many within these groups opposed cancellation, claiming it would disrupt industry; and the section chiefs concurred that by any action except opposition to the War Department cancellation proposals the Board would fail to keep faith with cooperating industries. As a result, when asked to review cancellation proposals, they vigorously objected to them.

The Vice Chairman of the Board, fearing he had been misunderstood, wrote a second memorandum on November 16 substantially repeating the earlier memorandum. When this had no effect, conferences of section chiefs were called by Mr. Bernard M. Baruch, Chairman of the Board. He asked the section chiefs if they had read the Vice Chairman's memoranda, and discovered that they had not. Mr. Baruch then expounded his views stating in part, "The power of the War Industries Board is a dead cock in the pit. Neither you, nor any body of men, can buy contracts that are going to be cancelled."<sup>33</sup>

In these conferences it was emphasized that the procurement agencies, not the War Industries Board, were responsible for cancellation. The War Industries Board was being apprized of cancellations so that it could more intelligently withdraw its regulations and release raw materials for civilian uses. The desire of the Chairman, in which he was admirably supported by the Vice Chairman, was that the section chiefs should merely "note" the cancellation proposals and return them to the War Department without comment. A third memoranda by the Vice

<sup>33</sup> National Archives, Records of the War Industries Board, File 21A-A2, tray 6.

Chairman, written on November 22, 1918, reiterated this position of the Board. Thereafter, section chiefs complied with Board policy without question.

The Board's policy while satisfactory to the policy making officials in the War Department gave rise to serious objections from two sources, namely: (a) the officials in the War Department charged with administering cancellations; and (b) industry. The War Department officials contended that their responsibility to Congress and to the people dictated a rapid reduction in the rate of expenditure on unneeded war goods. It is interesting to observe that when the War Industries Board began to "note" cancellations, the War Department administrators proceeded to collect statistics showing the number of schedules submitted to the Board at noon and not returned by six o'clock the same evening. They brought these statistics to the attention of the policy making officials.

At the same time, industry became disillusioned about the War Industries Board. Publicity releases shortly after the Armistice had misled industry into the belief that all cancellations would be approved by the Board. Many contractors requested the commodity sections to approve this cancellation or that cancellation or to modify the terms of yet another cancellation. Section chiefs, however, were powerless to comply with these requests. When the contractors were so informed, they expressed their dissatisfaction in the press or in letters to the Board or to Congress.

By late November, these influences had prepared both the Board and the War Department for abandoning the clearance procedure. Before any steps could be taken, however, a third agency, the United States Employment Service, had to be considered.

The Employment Service had not sought to influence plans for contract cancellation during the war, explaining later that its energy had been completely focussed upon securing new workers for war industries. On November 12, 1918, however, the Director of the Service's Clearance Division wrote to Felix Frankfurter, Chairman of the War Labor Policies Board, that he felt the cancellation of contracts might have a serious effect upon employment and that the Service should be consulted by the procuring agencies prior to cancellation in order that undue unemployment might be avoided.

Mr. Frankfurter undertook to secure the Service a place in the cancellation program. About November 15, he arranged with the War Industries Board for the Employment Service to share the clearance responsibilities. Under this arrangement, cancellation proposals from the War Department were delivered to the Facilities Section of the War Industries Board in which the Employment Service was represented. The Section routed one copy of the cancellation proposal to the appropriate commodity section of the Board and another to the Employment Service. After review, the proposals were returned to the Facilities Section which conciliated any differences in comment, or, in case there was serious objection to the proposal, arranged a conference between the Chairman of the Board and War Department policy officials to discuss the matter.

It soon became apparent that this procedure required too much time, and the machinery was streamlined by pairing off the reviewing representatives of the Service and the Board and providing them with authority to act independently. Even this new procedure required some time, however, and it failed to result in the assumption by either the Service or the Board of the right to approve or disapprove cancellations.

The Employment Service was willing to play a responsible role in the cancellation program. It vigorously objected to many cancellations, especially those resulting in sudden discharge of large masses of workers and those resulting in further discharge of workers in areas already suffering from unemployment. In both of these objections, the Service received wholehearted support from industry. Its complaints, however, seldom resulted in modification of cancellation orders. Typical replies from the War Department were that the complaint came too late for the order to be withdrawn, and that the Department's investigation showed that no serious unemployment would result.

The subordinate position of the Employment Service in the clearance procedure probably contributed to the disheartening disregard of its recommendations. The Service had been invited to participate by the War Industries Board, not the War Department, and its responsibility was limited to that assumed by the Board. Finally, on December 4, 1918, the Employment Service recommended a six point program of decentralization and proposed that the centralized clearance be abandoned. This was presented in a memorandum to the Director of the Purchase, Storage and Traffic Division, as follows:

1. That it be ascertained whether the cancellation or curtailment of contracts will involve displacement of labor.
2. That all contracts, cancellation or curtailment of which will cause displacement of labor be so terminated or curtailed that the release of labor be gradual, taking into consideration the ability of the particular community to absorb the number and kind of laborers that will be released.
3. That no contract should be terminated or canceled abruptly in such manner as to throw a considerable number of employees out of employment, when if tapered off the plant could be kept running until readjustment to the commercial basis has been established. Particular attention should be given to the case (a) where a town supports a single industry (b) where the plant concerned employs very large numbers.
4. Consideration should also be given with reference to other cancellations in the same community which have caused displacement of labor in other industries.
5. In cases where a plant has been engaged 100 percent on war work, consideration should be given to allow an additional quantity to be manufactured in order to permit the tapering off necessary to prevent considerable unemployment.
6. Where orders are being curtailed but not cancelled and when such orders are to be allowed to remain with several plants, the allocation should be determined

with a view to the labor situation in the plants and in the communities in which the plants are located, allowing greater quantity to be produced in places where there is the least power of absorption.

The Purchase, Storage and Traffic Division accepted these recommendations on December 5. In its reply to the Employment Service, it commented upon the relatively small effect the cancellation program had had upon employment. In its notice to the supply bureaus it released them from further clearance of cancellation proposals and urged them to adopt the Employment Service's six points to guide future cancellations. However, the Service's recommendation contemplated authority over cancellations at the District Claims Board level, while the War Department only decentralized authority to the several supply bureaus.

The supply bureaus promptly began to order cancellations without consultation with any other agency. Their procurement branches determined the sequence of cancellations and transmitted needed orders to the District Claims Board or to the Contracting Officers. The latter made a routine examination to see if the proposed cancellation would result in "labor disturbances," and, if not, promptly sent the notice to the manufacturer.

As a result of circularization to all State Directors of Employment of the six points to govern future cancellations, these officials expected the District Claims Board to consult with them. When the Boards failed to request such consultation, the State Employment Directors attempted to establish the liaison on the basis of the December 4 and 5 letters. They soon found that the Boards considered themselves directly responsible to the supply bureaus and unable, therefore, to delay or revise the cancellation orders transmitted by the bureaus.

Failing to secure liaison with the District Claims Boards, the State Employment Directors sought assistance from the Employment Service. That latter agency again approached the Purchase, Storage and Traffic Division complaining that the agreed procedure of December 4 and 5 was not being followed. In reply, the Division indicated that industrialists desiring to continue profitable manufacture of munitions were using the threat of unemployment to secure a continuation of their war contracts; that by this time, mid-December, manufacturers had been given ample opportunity to begin to convert from war production to peace-time activities, and that the tapered production policy adopted by the War Department provided sufficient time to terminate the contract so that no undue hardships should result.

Against this defense of the War Department's action, the Employment Service could make no headway. It fell back upon a program of opposing only cancellations in cities already having a large surplus of labor,—such as Bridgeport and New Haven, Connecticut; Cleveland, Ohio; and Bay City, Michigan. Here again, however, it learned of cancellations only after they were ordered, and the War Department claimed this was too late to revise them. The resulting impasse left the

Employment Service impotent, and so it remained until the cancellations were completed, about mid-February, 1919.

The rate of cancellation was extremely rapid throughout the period from November 11, 1918, to February, 1919. However, it affected different industries at different times. The bulk of cancellations ordered between November 11, and December 5, the period of inter-agency clearance, involved either contracts exempted from the clearance or Quartermaster Corps contracts. During this period cancellations removed from industry's order books approximately 2.5 billions dollars worth of future production, roughly one-third of which consisted of contracts negotiated after October 1, 1918.

After December 5, 1918, the bulk of the cancellations consisted of Ordnance Department contracts. During the period prior to February 13, 1919, when cancellations reached their maximum value, the following cumulative figures appear:

December 5, 1918—2.5 billions  
January 4, 1919—5.1 billions  
February 13, 1919—7.4 billions

In three short months after the Armistice, the War Department cancelled all outstanding orders for supplies no longer required. At the same time it began settling claims arising from the cancellation of these contracts.

Where contracts contained termination clauses specifying the basis of settlement, settlement proceeded according to the terms of these contractual provisions. In order to deal with contracts containing no termination clause, or containing a clause which did not indicate the elements of compensation, the War Department devised a formula. As finally developed it provided that the Government would reimburse the contractor, as follows:

A. For raw materials, direct and indirect, and component parts on hand, in an amount not exceeding the requirement for the completion of the contract: Cost, plus inward handling charges, plus such portion of overhead as is applicable, less such sums as may represent the fair agreed value of all or any portion thereof if title and possession of the same are retained by the contractor.

B. For articles in process, in an amount not exceeding the requirements for the completion of the contract: Cost of raw materials and labor plus such portion of overhead as is directly applicable, less such sums as may represent the fair agreed value of all or any portion thereof if the title and possession of the same are retained by the contractor.

C. A fair and equitable remuneration (1) for expenses and services of the contractor in connection with the items included in Section A but not to exceed interest at six percent per annum on the capital invested therein, or if the capital was borrowed, interest at the rate paid by the contractor; and (2) for expenses and services of the contractor in connection with the items included in Section B, but not to exceed ten percent of the cost thereof.

D. Such amounts as are properly paid by the contractor in the adjustment and termination of unperformed subcontracts and unperformed commitments for supplies which were properly entered into or made in connection with the performance of the original contract.

E. Payrolls and expenses paid or incurred with the approval of the contracting officer, or properly paid or incurred without such approval, for the custody and protection of property since the date of suspension and pending final settlement.

F. Where special facilities were properly provided in connection with the performance of the original contract, necessity of which was contemplated by the contractor and included in his estimate of cost at the time the original contract was made, such portion of the cost thereof as would reasonably have been recouped had the uncompleted portion of the original contract been performed. The amount so allowed not to exceed a sum to be computed as follows: From the cost of such special facilities deduct their fair value at the date hereof, and state such portion of the remainder as is represented by the ratio of the uncompleted portion to the whole of the original contract.

G. Such additional sums, if any, as the Secretary of War may deem necessary, fairly and justly to compensate the contractor for expenditure, obligations, and liabilities necessarily incurred, including work, labor, and service necessarily rendered, under the original contract or in preparation for the performance thereof, or under a supplemental agreement.

This basis of settlement omitted reference to at least four classes of expenses, namely: (1) compensation for completed articles. The War Department paid the contract price for such articles without question and no claim was needed. (2) There was no provision for payment of interest on the claims after they were filed and before the award was paid, because such interest payments were contrary to law. (3) "Liquidated damages," *i.e.* deductions from payments made to the contractor as a result of delayed deliveries, were not returned to the contractor because the Comptroller of the Treasury had held such payments to be a money right of the government returnable only by the Court of Claims. (4) War Department policy precluded payment of dismissal wages although actual expenditures for labor received were allowed. In the DuPont smokeless powder case, and maybe a few others, this policy was laid aside and the company reimbursed for actual expenditures including dismissal wages.

In an attempt to minimize the financial consequences of delays in the settlement of contracts, provision was made for partial payments on claims prior to a final settlement. The first adopted policy was to advance 75 percent of the face value of the claim as soon as it was filed, but the Comptroller of the Treasury held that in the absence of specific statutory authority such payments were illegal because they might entail disbursement of Government funds beyond those actually due the contractor. The Department then turned to the policy of making partial

payments covering sections of the claim as they were approved and not holding up all payments pending a final settlement. But in spite of specific authorization of the War Department, the officials charged with making these advance payments appear to have been reluctant to act under this authority and as a consequence only a nominal amount was advanced.

The administrative organization for claim settlement in the War Department was based upon decentralized authority and centralized responsibility. The initial contact of the war contractor with the claim settlement organization came when he filed his claim. He directed it to the District Claims Boards of the Ordnance and Quartermaster supply bureaus,<sup>34</sup> or to the contracting officers of the other supply bureaus. Since the Ordnance Department and the Quartermaster Corps accounted for more than eighty percent of the total contracts, the following discussion of administrative procedure is based upon their experience.

The District Claims Boards, twenty-seven in number, received the claims, verified them through audit of the manufacturer's accounts and through logical comparison with the requirements of the contract, adjusted them in conference with the contractors, and made preliminary awards. The awards were submitted to the manufacturers for their information and to the supply bureau claims boards for review and approval.

Supply bureau claims boards,<sup>35</sup> thirteen in number, reviewed the preliminary awards including in the review a second comparison of the claims with the requirements of the contract and an examination of the District Claims Board's method in arriving at the award. They established the rules under which the District Claims Boards operated. These boards also heard contractor's appeals from the preliminary awards, reserving the right to modify those awards upon sufficient evidence. If the decision of the supply bureau claims boards proved unsatisfactory, the contractor could appeal to the Board of Contract Adjustment.<sup>36</sup>

However, if the supply bureau claims board approved the District Claims Board's award and the contractor made no appeal, the award was sent to the War

<sup>34</sup> Called zone offices in Quartermaster Corps.

<sup>35</sup> Also called Boards of Review.

<sup>36</sup> The Board of Contract Adjustment had been established late in the war to act for the Secretary of War in adjusting contractors' grievances under war contracts. Its jurisdiction was "to hear any such claims, doubts, or disputes as are not disposed of by mutual agreement between the contractor and the officer representing the Government in charge of the contract." Its membership was made up entirely of well known businessmen and lawyers and these were served by a staff of examiners, later called Government Attorneys. The Board followed accepted court procedure: each appeal was given a hearing with a member or several members of the Board presiding. The contractor presented evidence supporting his appeal; a Government attorney presented the Government's case. Witnesses for either side were both examined and cross-examined, and the examination was frequently extended by direct questioning from the presiding member. After consideration of the facts brought out at the hearing, the presiding member gave a decision which usually reviewed the main facts and laid down the principles for the settlement; or, if the issues were complicated and important, he occasionally conferred with other members of the Board before giving a decision. The case was then referred back to the appropriate supply bureau for action in accordance with the decision. (FINAL REPORT OF THE BOARD OF CONTRACT ADJUSTMENT. Par. 14.) If the claim was based upon real estate, appeal was made to the Board of Appraisers, and if based upon transportation, to the Transportation Service.

Department Claims Board for final approval. No final settlement payment could be made prior to the approval of this Board. In addition, the War Department Claims Board established the rules and regulations under which the other boards operated. Finally, it usually acted for the Secretary of War in appeals from decisions of the Board of Contract Adjustment.

Many were the problems that caused delay in the operation of this machinery. The contractors failed to present claims with alacrity. The War Department went so far as to send out representatives to help manufacturers draw up their claims. Finally, it concluded, and rightly so, that contractors did not intend to file claims under all of their canceled contracts.

Inadequate liaison between the various claims boards also caused difficulty. At first the District Claims Boards cautiously examined each claim before making an award. They were accused of failing to appreciate the spirit in which the War Department wished to settle the claims. The War Department Claims Board and the supply bureaus claims boards undertook to improve liaison by keeping a few of their members in the field in direct contact with the District Claims Boards.

Although the settlement basis involved a minimum of accounting and although the War Department negotiated settlements on a "give and take" basis, all of the claims boards experienced special difficulty in securing an adequate number of accountants. To alleviate the shortage, they eliminated duplication of audits by such means as using a common agent with the contractor in checking subcontractor's claims.

Serious delays also centered about the question of raw materials. First of all there was the question of raw material inventories. These had to be presented in the claims separated by contract, and few manufacturers kept their inventories so segregated. Second, there was the problem of accounting for Government owned property. Many manufacturers also had difficulty in segregating all of this from their own inventories. Finally, there was the problem of salvaging the Government owned materials. This was frequently accomplished by inducing the contractor to make an offer, which, if it reasonably conformed with current market values at the time of the offer, usually was accepted and the amount offered was deducted from the contractor's claim.

The claims organization was very concerned over the claims of subcontractors and made every effort to expedite payment of these claims. The War Department Claims Boards authorized and requested the District Claims Boards to make partial payments covering subcontractor's claims as soon as they were verified, and specifically urged that these payments be made as each one of the subcontractor's claims were cleared rather than waiting for all of them to be approved.

But the greatest single delay in the administrative settlement of war contracts involved the so-called "informal" contracts. In the rush to expedite immediate production of munitions, the War Department had entered into several thousand

contracts in a manner that did not conform to existing statutory requirements. In many cases, orders had been given and work performed without the contract ever having been reduced to a writing. In others, "proxy signed"<sup>37</sup> contracts had been executed. Both of these situations involved a violation of terms of Revised Statutes, sections 3744 and 3745,<sup>38</sup> the former requiring that all contracts of the War, Navy, and Interior Departments be reduced to a writing signed by the contracting parties, and the latter requiring that the contracting officer's signature be notarized as his own.

The Secretary of War was anxious to settle these contracts by a supplemental agreement fair to both parties; but realizing that the Comptroller of the Treasury might possibly refuse payment,<sup>39</sup> he submitted the proposed plan of settlement for the latter's approval. The Comptroller of the Treasury on November 25, 1918<sup>40</sup> held that supplemental agreements for the payment of claims arising from the cancellation of informal contracts could not be honored since they would be based upon a void original agreement.

The legal sufficiency of this unfortunate ruling is open to question. It has been pointed out that informal contracts were not void but merely voidable at the option of the Government. If the Secretary of War had wished to recognize them as valid they could have been enforced against the contractor, or on the other hand, formal contracts might properly have been substituted for them and signed by the parties as required by Statute and then cancelled according to supplemental agreement.<sup>41</sup>

The practical implications of this decision were most serious. Having sought the decision of the Comptroller of the Treasury, the Secretary of War was bound to abide by it. As such he could not terminate informal contracts by any lawful method except by refusing to perform and relegating the contractor to litigation in an attempt to recover on a *quantum meruit* or a *quantum valebat*.<sup>42</sup>

Accordingly, the Secretary of War requested Congress to pass legislation permitting a rapid and just settlement of informal contract claims. The matter was given thorough, though somewhat lengthy, consideration, finally resulting in the Dent Act enacted into law on March 2, 1919.<sup>43</sup> This legislation authorized the

<sup>37</sup> These contracts were drawn in the name of some contracting officer whose name also appeared in the signature for the United States, but the contract had in fact been signed by another officer, the latter subscribing his name to the signature.

<sup>38</sup> 36 STAT. 261 (1910).

<sup>39</sup> On Oct. 21, 1918 the Comptroller of the Treasury had held that a contract made in violation of section 3744 was void, and afforded the contractor no legal claim against the Government. 25 COMP. TREAS. 331 (1918).

<sup>40</sup> 25 COMP. TREAS. 398 (1918).

<sup>41</sup> SHEALEY, THE LAW OF GOVERNMENT CONTRACTS (1919) 130.

<sup>42</sup> It had been well established that, though contracts made in violation of sections 3744 and 3745 were unenforceable as such, they were unlike illegal contracts in that recovery could be had upon a *quantum meruit* or *quantum valebat*. Clark v. United States, 95 U. S. 539 (1877); United States v. Andrews, 207 U. S. 229 (1907); 6 WILLISTON, CONTRACTS (rev. ed. 1938) 5022 ff.

<sup>43</sup> 40 STAT. 1272, Amended Nov. 23, 1921, 42 STAT. 322; Feb. 13, 1929, 45 STAT. 1166; May 18, 1936, 49 STAT. 1355, June 30, 1936, 40 STAT. 2040.

Secretary of War to settle contracts not executed according to law, where such contracts had been performed in whole or in part, expenditures made or obligations incurred prior to November 12, 1918, and where the claim had been presented before June 13, 1919.

The Act further delegated jurisdiction to the Court of Claims to find and award compensation in the event that the contractor refused to accept the adjustment of the War Department or the latter failed to make a satisfactory adjustment.<sup>44</sup> It was specifically provided, however, that "in no case shall any award, either by the Secretary of War or the Court of Claims, include prospective or possible profits." Finally, the Dent Act required the Secretary of War to make certain that subcontractor's claims had been settled before payment was made to the prime contractor, and authorized the Secretary to settle directly the claims of subcontractors unable to secure satisfaction from their prime contractors.<sup>45</sup>

In spite of these delays and many others, administrative settlements were effected quickly, though not so quickly as the War Department Claims Board had hoped. The Board set May 1919, as the date when settlements should be completed. But on that date less than one-half the number of claims had been adjusted.

In July, however, the Board thought the time had passed when industry would be seriously hampered by a very detailed investigation of each claim and it began to tighten procedures. This became evident in September 1919 when a comparison of the number and value of settlement in August and September showed a drop of sixty-six percent. During the following months, the Board paid increasing attention to errors in the awards and to windfalls contractors might receive through so-called "dollar awards."<sup>46</sup>

Continuing with this policy of increased caution, the Board in October, 1919 established a special audit committee to review all settlements, both completed and in process, so as to recover any duplicate payments. It was felt, for example, that

<sup>44</sup> Subsequent holdings of the Court of Claims established the rule that the jurisdiction of the Court of Claims does not attach in Dent Act cases until an appeal has been taken to the Secretary of War from a ruling of the Board of Contract Adjustment. *U. S. Bedding Co. v. United States*, 55 Ct. Cl. 459 (1920); *Baum, Trustee v. United States*, 64 Ct. Cl. 323 (1927), *Philadelphia Boiler Works v. United States*, 67 Ct. Cl. 311 (1929).

<sup>45</sup> The administrative organization for the handling of Dent Act claims has been most clearly described by J. R. Delafield, *FINAL REPORT OF THE BOARD OF CONTRACT ADJUSTMENT OF THE WAR DEPARTMENT* (1920): "After the passage of this act (the Dent Act) the claims of manufacturers of supplies for the Army were classified roughly into two groups. First, claims upon suspended contracts, which had been formally entered into and executed in the manner prescribed by law . . . and second, those contracts which had not been so executed. The latter were further subdivided into two classes called A and B. The class A claims were those on informal contracts which were evidenced by writings and the Bureau Boards and contracting officers were given the original jurisdiction to adjust these subjects to a right of appeal to this board. The class B claims included all others, and consisted generally of claims on agreements made on behalf of the Secretary of War when not based on written evidence. . . . Original jurisdiction of these class B claims were fixed in the Board of Contract Adjustment with the exception of those relating to transportation and to real estate."

<sup>46</sup> Under these awards the contractor assured the Government that he had no claims against the Government, and in exchange he received one dollar and a pledge that the Government had no claims against him. The Claims Board felt that the latter pledge might conceal sizable amounts otherwise recoverable by the Government.

contractors with several contracts for similar commodities might inadvertently have included the same component materials in more than one claim and been reimbursed for them more than once. No record is available as to the success of the special audit committee although it is known to have made several recoveries.

The settlement of claims as of April, 1921, may briefly be summarized as follows:<sup>47</sup>

Number of claims filed .....	31,400
Number requiring settlement .....	26,150
Number settled .....	24,900
Value of Production cancelled under contracts settled .....	\$3,600,000,000
Number of settlements requiring disbursement by Government .....	12,250
Amount disbursed by Government .....	\$ 490,000,000

The above statistics show that by April 1921, only thirty months after the Armistice, the War Department had adjusted all but 1,250 of the claims contractors had filed under their war contracts. Somewhat less than one-half of the settlements involved disbursement of Government funds, amounting to less than 14 percent of the amount the Government would have had to spend had the contracts been completed.

As the number of claims remaining to be adjusted became smaller, the War Department began to curtail its claim settlement machinery. It closed the District Claims Boards as soon as the number of claims within their jurisdiction failed to provide them with work, and left only a skeleton cost accounting section to take care of such small details as might be left in that district. The supply bureau claims boards were constituted sections of the War Department Claims Board by November 1919, and were officially abolished in July 1920; the War Department Claims Board assuming full responsibility for the remaining 1,900 claims.

Finally, in March 1922, when less than thirty claims remained unsettled, the War Department Claims Board was abolished. Most of its duties and responsibilities were transferred to the office of the Assistant Secretary of War.

The administrative settlement of contract claims was virtually completed; but the task of the courts had just begun. Many contractors, not bound by their agreements or by statutes to enter into administrative settlements, preferred to take their chances with the courts.<sup>48</sup> Administrative settlements, involved numerous disputes

<sup>47</sup> It is important to note that available data do not indicate the amount claimed by contractors after their contracts were cancelled. As such, it is not possible to state the relationship between the amount disbursed by the Government and the amount claimed by contractors. Currently popular statements that World War I settlements averaged 13c on the dollar express the much less significant relationship between the value of cancelled contracts and the amount disbursed by the Government.

<sup>48</sup> Originally the Federal Government did not allow itself to be sued upon its contracts. The only remedy available was to petition Congress for the payment of claims founded on contracts. In 1855 Congress established the Court of Claims with jurisdiction to determine claims against the United States based on, among other things, "an express or implied contract with the Government" (10

that could only be determined by the courts. The acts governing special types of contract cancellations—the Act of June 15, 1917, and the Dent Act—give rise to a host of problems of interpretation. As a result, innumerable cases were instigated—about 3,000 in the Court of Claims alone. They averaged three and one half years for final settlement; many represent masterpieces of dragged-out litigation.<sup>49</sup>

The problem of payment for loss of anticipated profits was the central issue in much of the war contract litigation. It arose in connection with virtually every form of agreement, and in almost every case the courts were persistent in their denial of recovery. It was held, for example, that, where a contract contains a termination clause omitting reference to prospective profits, that clause governs the settlement, and no payment for loss of prospective profits may be made.<sup>50</sup> Similarly, prospective profits were refused in cases of contracts containing no cancellation provisions, where the right to terminate was based on principles of general law. In this connection the courts, on occasion, based their decision on the doctrine of "frustration of purpose," already referred to.<sup>51</sup> Thus in one case the court, holding that the Government could not be held liable for the ordinary measure of damages in cancelling war contracts, pointed out:<sup>52</sup> "It was within the contemplation of the parties, when the order for iron was accepted, that the contract would become abrogated upon termination of the purpose for which it existed."

Closely related problems arose in the judicial interpretation of the "just compensation" provision of the Act of June 15, 1917, governing the cancellation of Navy Department and Emergency Fleet Corporation contracts.<sup>53</sup> The term "Just compensation" was not new to the courts. The fifth amendment to the Federal Constitution provides: ". . . nor shall private property be taken for public use without 'just compensation,' . . ." and the vagueness of this expression had plagued the courts for many years. In a leading case on the subject, the Supreme Court had held that<sup>54</sup> "the just compensation required by the Constitution to be made to the owner is to be measured by the loss caused to him by the appropriation. He is to receive the value of what he has been deprived of, and no more." In spite of its stern tone, this doctrine, applied literally to the "just compensation" clause of the act of June 15, 1917, might well have dictated payment for loss of anticipated profits. The Court of Claims, however, adopted a contrary view. In connection with the cancellation of a contract with the Navy Department, it held<sup>55</sup> that the contractor was entitled to recover actual damages sustained by reason of the pro-

STAT. 612). This jurisdiction was later extended to include "damages, liquidated or unliquidated in cases not sounding in Tort," and gave the Federal District courts concurrent jurisdiction (24 STAT. 505). See Naylor, E. E., *The United States Court of Claims*, 29 Georgetown Law Journal 719 (1940).

<sup>49</sup> One case, for example, involving the Bethlehem Company, required 24 years for final settlement.

<sup>50</sup> *Dorris Motor Car Co. v. United States*, 60 Ct. Cl. 68 (1924) affirmed 271 U. S. 96 (1925). See also *Duesenberg Motors Corp. v. United States*, 56 Ct. Cl. 96 (1921) affirmed 260 U. S. 115 (1932).

<sup>51</sup> *Supra*, p. 571.

<sup>52</sup> *Buffalo Union Furnace Co. v. United States Shipping Board Emergency Fleet Corporation*, 283 Fed. 673 (1922).

<sup>53</sup> *Supra*, pp. 569, 570.

<sup>54</sup> *Bauman v. Ross*, 167 U. S. 548 (1896).

<sup>55</sup> *Meyer Scale and Hardware Co. v. United States*, 57 Ct. Cl. 26 (1922).

curement of materials, special tools on hand and so forth; but was not entitled to recover prospective profits. This view was reiterated by the Court of Claims and upheld subsequently by the Supreme Court on numerous occasions.<sup>56</sup> In one case the Court in denying compensation for anticipated profits said,<sup>57</sup> "At that point, (the date of cancellation of the contract) as by a distinct line of demarcation, the future is separated from the past and adjustment of rights on the basis of just compensation to the contractor has its proper field of operation behind, and not beyond this line."

The specific denial of anticipated profits by the terms of the Dent Act limited the number of such cases arising in the settlement of informal contracts. On at least one occasion, however, the Court of Claims held<sup>58</sup> that a claim for the recovery of incidental expenses, such as tools, facilities, patterns, etc., which might have been absorbed if the contract had been completed was in the nature of a claim for prospective profits the granting of which was prohibited under the Dent Act.

Other provisions of the Dent Act gave rise to considerable litigation. The courts apparently adopted the view that the Dent Act did not validate informal contracts, but rather created a new statutory right in a particular class of war contractors separate and distinct from their rights under their invalid contracts.<sup>59</sup> As such the courts required strict compliance with the conditions for recovery specified in the Act. For example, numerous cases arose in which the Court of Claims held that recovery must be denied because the required "express or implied contracts" could not be demonstrated, or the Government agent, in entering into the informal contract was not acting within the scope of his authority.<sup>60</sup>

#### REVIEW OF CONTRACT SETTLEMENTS BY THE DEPARTMENT OF JUSTICE

Secretary of War Newton D. Baker, writing of the cancellation and settlement of World War I contracts in 1921 said:<sup>61</sup>

"It gives me great delight to be able to say that in all that vast and intricate undertaking it was so rare a thing that I do not now recall an instance of finding a business or a businessman who really was seeking to take an unjust advantage of his Government by reason of these contracts."

But these comforting sentiments by no means reflected the unanimous opinion of those interested in the settlement of Government war contracts. Indeed the

<sup>56</sup> *De Laval Steam Turbine Co. v. United States*, 284 U. S. 61 (1931); *College Point Boat Corp. v. United States*, 267 U. S. 12 (1924); *Russell Motor Car Co. v. United States*, 261 U. S. 514 (1923); *Enright v. United States*, 73 Ct. Cl. 416 (1931); *Nitro Powder Co. v. United States*, 71 Ct. Cl. 369 (1930); *Harrisburg Pipe and Pipe Bending Co. v. United States*, 67 Ct. Cl. 138 (1929).

<sup>57</sup> *Russell Motor Car Co. v. United States*, 261 U. S. 514 (1923).

<sup>58</sup> *Twin City Forge and Foundry Co. v. United States*, 60 Ct. Cl. 673 (1925).

<sup>59</sup> This position was set forth in Harriman, *Government Contracts and the Dent Act* (1921) 1 B. U. L. REV. 21.

<sup>60</sup> *Baltimore & Ohio R. R. v. United States*, 57 Ct. Cl. 140 (1922); *United Gas and Electric Engineering Corp. v. United States*, 59 Ct. Cl. 176 (1924); *Nixon v. United States*, 59 Ct. Cl. 684 (1924); *American Rolling Mill Co. v. United States*, 61 Ct. Cl. 882 (1926); *Kendall, Trustee v. United States*, 70 Ct. Cl. 90 (1930).

<sup>61</sup> Baker, *Some Legal Phases of the War* (1921) 7 A. B. A. JOUR. 321, 328.

familiar charges of fraud, profiteering, and graft were audible long before the job of settling canceled war contracts had been completed. By June of 1919 these complaints had resulted in the establishment of the "Select Committee on Expenditures in the War Department," which conducted a nine-month investigation of alleged frauds in connection with war contracts. This investigation, while rather extensive, was necessarily superficial, and inconclusive; and the curiosity it aroused soon made the demands for a more intensive and systematic examination of alleged frauds irresistible.

As a result, in May of 1922 Congress appropriated \$500,000 "to be expended in the discretion of the Attorney General . . . for the investigation and prosecution of alleged frauds, either civil or criminal, or other crimes against the United States growing out of or arising in connection with the prosecution of the late war."<sup>62</sup> On July 20, 1922 the Attorney General, in pursuance of this enactment, ordered the creation of the War Transactions Section within the Department of Justice.

For almost four years this unit busied itself with a wholesale reexamination of war contract settlements.<sup>63</sup> In February of 1923, when the inquisition movement reached its climax, it joined forces with the War Department in the form of a Joint Board of Survey. The group was established to examine literally *all* war transactions in the War Department which had not hitherto been audited or reported to the War Transactions Section.

The desire to discover actual fraud, as that term is commonly used, clearly provided the initial impetus for the creation of the War Transactions Section. In fact, little actual fraud was discovered. Such was the clear admission of the directors of the Section. In their final report they pointed out that,<sup>64</sup> "charges that fraud and profiteering were committed on a large scale have been frequent, and yet comparatively few cases involving actual fraud have been discovered. Although thirty-seven indictments charging war frauds have been retained, only two convictions, and two pleas of guilty have been obtained."

But from the very beginning the personnel of the War Transactions Section were least interested in cases involving actual fraud in the settlement of war contracts. There was a very strong feeling that Government funds had been blatantly wasted, not through the dishonesty of either the contractor or the Government agents; but through the incompetence, inexperience, and bad judgment of many of the Government agents who had conducted contract settlements. As a result, it was felt, a large number of settlements were made without considering certain legal principles plainly applicable thereto; or that hasty settlements at unconscionable prices had been made. "Constructive fraud," long a bugaboo of the courts, reared its ugly head.

<sup>62</sup> 42 STAT. 543 (1922).

<sup>63</sup> An excellent statement of the administrative history of the War Transactions Section is presented in a document to be found in the National Archives—Harvey J. Winters, *An Unpublished Preliminary Checklist of the War Transactions Section Records*. (Data for exact citation not available. Ed.)

<sup>64</sup> FINAL REPORT OF THE WAR TRANSACTIONS SECTION, June 30, 1926.

Nor was it difficult to establish the legal right of the Government to recover money paid in the settlement of contract claims, even in the absence of a showing of actual fraud. The Supreme Court had held on several occasions that the Government is not bound by the acts of its officers, making an unauthorized payment, and this whether the act springs from a mistake of fact or a mistake of law, and whether or not actual fraud is present.<sup>65</sup> Nor could the doctrine of laches, or the statutes of limitation be raised to avoid recovery of such unauthorized payments. The fact that the United States is not bound by any statute of limitations nor barred by laches of its officers was clearly established.<sup>66</sup>

Armed with this strong legal sanction the War Transactions Section proceeded with an investigation of each settlement that went far beyond the question of actual fraud. The following outline used by the attorneys of the Section as a guide to their investigations is indicative of the extremely wide range of considerations upon which war contract settlements were reopened.

*Outline of Questions of Law Involved in Examination of  
Ordinance War-Time Contracts*

I. *Authority*

A. Did Contracting Officer have authority to enter into the contract for the Government?

- (1) Was Contracting Officer authorized to execute the contract?
- (2) Was limit of his authority exceeded?

II. *Contents*

- A. Subject matter or purpose legal?
- B. Material or services of contract necessary?
- C. Is contract capable of performance?

III. *Validity*

A. Formal

- (1) Within R. S. 3744?
- (2) Exceptions to R. S. 3744. Comp. Stat. 6853 a, b, c, & 6854?

B. Informal

- (1) Express?
- (2) Implied—was there ever a contract?

C. Is contract within Dent Act?

- (1) War-time contract?
- (2) Expenses incurred on it?
- (3) Bona fide, and other provisions?

D. Valid under Sec. 120, National Defense Act, 1916?

<sup>65</sup> *United States v. Barlow*, 132 U. S. 271 (1889); *Wisconsin Central R. R. Co. v. United States*, 164 U. S. 190 (1896); *Pine River Logging Co. v. United States*, 186 U. S. 279 (1901).

<sup>66</sup> *United States v. Beebe*, 127 U. S. 338 (1887); *United States v. Nashville, Chattanooga and St. Louis R. R. Co.*, 118 U. S. 120 (1885); *United States v. Kirkpatrick*, 9 Wheat. 720 (U. S. 1824).

*IV. Amendments, Reformation, etc.*

- A. Execution valid?
- B. In interest of the Government?
- C. Consideration?

*V. Suspension, Cancellation, Termination*

- A. Did United States have right to suspend, cancel or terminate before completion?
  - (1) Under the contract terms?
  - (2) On public policy?
  - (3) Because of breach by contractor?
- B. Legal status of contractor when contract terminated?
  - (1) Duties under the contract?
  - (2) Rights under contract?
- C. Legal effect of "suspension?"

*VI. Settlement after Termination*

- A. Formal contracts.
  - (1) Was settlement in accordance with termination clause, if any?
  - (2) Was the contractor in fault?
  - (3) Were items allowed as "costs" properly costs?
- B. Informal.
  - (1) Did settlement violate provisions of Dent Act?
    - (a) Was claim "presented" prior to June 30, 1919, as required by the Act?
    - (b) Were the allowances "just compensation?"
  - (2) Were any of the following or other items allowed illegal as costs, etc.?
    - (a) Interest
      - (x) On the claim?
      - (y) As profit?
      - (z) As cost?
    - (b) Amortization?
    - (c) Overhead?
    - (d) Labor
      - (x) Direct?
      - (y) Indirect?
    - (e) Profit
      - (x) Anticipated?
      - (y) On investment?
    - (f) Storage, rent, etc.?
    - (g) Bonuses
      - (x) For savings?
      - (y) To employees or officers?
    - (h) Remission of liquidated damages?

- (i) Excess of material?
- (j) Preparation of the claim—auditing, inventory, etc.?
- (k) Rehabilitation, etc.?
- (l) Expenses in procuring contract, as for traveling, etc.?
- (m) Loss due to delay of United States?
- (n) Insurance?
- (o) Commitments?
- (p) Preparatory expense?
- (3) Did Secretary of War exceed his power in settling contract?
  - (a) Were items for expense accruing after termination allowed, and, if so, are they recoverable?
  - (b) Were items awarded that were not found on, but arising prior to execution of, contract, or subsequent to the termination of it?
  - (c) Did the Secretary of War (or his agents) have all the facts before him when settlement was made?
  - (d) Was there material mistake of law or fact in award of any item?
- (4) Is the settlement binding on the United States?
- (5) If an item of claim is recoverable, could the contractor recover it back in the Court of Claims?

## VII. *Fraud*

### A. Did fraud enter into the:

- (1) Procurement of the contract?
- (2) Operation of the contract?
- (3) Settlement of the contract?

### B. To what extent, in case of fraud, is the contract vitiated?

## VIII. *Miscellaneous*

Questions covering whole realm of civil law, and more particularly trusts, bankruptcy, real property, sales, mortgages, agency and corporations.

Sentiment in the War Transactions Section was especially strong in favor of a wholesale reopening of settlements made under the Dent Act. There was a strong feeling that the War Department had given an unnecessarily liberal construction to the legislative intent behind the Dent Act, paying, without question, the stated contract price in the majority of settlements. It was argued that if the Dent Act validated informal contracts it did not necessarily validate the contract prices, and that Dent Act settlements to be legal must have conformed to the letter of the Act, which authorized the Secretary of War to adjust informal contracts upon "a fair and equitable basis."

In the reopening of Dent Act settlements, however, the War Termination Section faced a serious legal problem. The Act had specified that settlements made were not to bar the United States "from the right of review of such settlement, nor the right of recovery of any money paid by the Government . . . if the Government

has been defrauded." On the one hand it was argued that this proviso by implication prohibited suits by the Government based on Dent Act settlements except where fraud had been practiced. Without this proviso the Government could have been able to recover for overpayments made merely through mistake of fact or law as well as through fraud. This proviso, by omitting reference to any basis but fraud, limited recovery to cases of fraud.

On the other hand it was contended that it was not the intention of Congress in employing the word "defrauded" to nullify the pre-existing rights of the Government to maintain actions for money erroneously paid or to limit them to those cases where fraud was present. Although the first of these views was upheld in a case before the Court of Claims,<sup>67</sup> the War Transactions Section apparently adopted the latter. The outline presented above clearly indicates the fact that the reopening of Dent Act settlements was by no means confined to cases involving fraud.

During the four years of its existence 955 cases were referred to the Section, although only 615 had been finally disposed of when the unit ceased operations in June of 1926.<sup>68</sup> In all about \$13 million was recovered, and about \$2½ million spent.

#### LESSONS TO BE DRAWN

What, then can we say of the termination and settlement of contracts in the last World War; and what does it teach us that can be made use of as we approach a similar problem today?

In general, it is fair to say that the agencies charged with the cancellation and settlement of war contracts proceeded as expeditiously and effectively as could be expected in the light of the very meagre preparations that had been made. It is, however, in the lack of adequate preparation for cancellation that the greatest weakness of the job that was done may be found. Thinking on the problem of contract termination was indeed "too little and too late." Valuable time was lost, and considerable confusion ensued because of the lack of plans for cancellation and settlement, thought out and publicized in advance of the time when the need for action had actually arisen. Especially significant was the failure to recognize generally that the contract termination problem is one aspect of the larger problem of reconversion to a peace-time economy; and that as a consequence adequate preparation for contract termination must necessarily include plans for dealing with the specific repercussions of cancellation upon industry and labor.

The difficulties which resulted from the lack of a uniform termination clause in war contracts have already been described at some length. The problem cannot be overstressed. It is clear, of course, that the mere existence of a standard uniform

<sup>67</sup> *Standard Steel Car Co. v. United States*, 60 Ct. Cl. 726 (1925).

<sup>68</sup> A partial explanation of the large number of unsettled cases appears in the following statement of the Attorney General: "The courts are cooperating to the end that justice may be done, but they take the position that these cases, whether civil or criminal are entitled to no precedence over other cases on the court dockets." *ANNUAL REPORT OF THE ATTORNEY GENERAL OF THE UNITED STATES* (1923) 5.

termination clause cannot of itself effect a speedy, economically sensible termination and settlement program. It serves only to state, in advance, the conditions of cancellation, and the basis of settlement; but in that it serves well. It allows both the contractor and the Government to prepare in advance for the exigencies to come. In a problem where speed is the keynote such preparation is of the utmost importance.

The lesson to be drawn from the situation which led to the passage of the Dent Act is obvious. Today, as in World War I thousands of "informal" war contracts are in existence. It is true that the sweeping terms of the Second War Powers Act and Executive Order 9001 would appear to suspend virtually all of the usual statutes governing the execution and form of Government contracts, as far as war contracts are concerned. This may not suffice, however. There were few who had serious qualms concerning the duty of the Government to reimburse the holders of informal contracts prior to the decision of the Comptroller of the Treasury on November 25, 1918. Specific statutory validation of informal contracts might well be a worthwhile precaution.

The flooding of the courts with claims and disputes which could not be settled by the administrative agencies is another phase of World War I contract termination worthy of serious consideration. Litigation is inherently slow and costly process; consideration should be given to methods for settling disputes arising out of administrative settlements based upon local arbitration.

But perhaps the phase of World War I contract termination that should be most carefully scrutinized and evaluated is the four-year reexamination of settlements by the Department of Justice. The War Department in settling contract claims after World War I faced a huge task with a relatively small amount of trained personnel. As such, it had to choose between a settlement that was meticulous and accurate and one that was just and speedy. Wisely, it generally chose the latter. This time the contracting agencies will face the same problem; and must be guided by the realization that the cost of meticulous settlements in terms of delayed transition to peacetime production, and in terms of unemployment may far outweigh the dollar and cents cost of rapid settlements. This is not to sanction fraud, or settlements which are really unconscionable. The investigation of such settlements and the recoupment of public funds so spent must remain a legitimate function of the Department of Justice. But in the absence of such factors it may be wiser to consider war contract settlements as *final* in every sense of the word. Contractors today are fully aware of the wholesale inquisition which followed the payment of contract claims after World War I. Their apprehension that this will be repeated may seriously hamper their use of funds received in contract settlements and delay the all-important postwar expansion of peacetime economic activity.