

# Government Contracts Blog

Posted at 2:11 PM on November 9, 2009 by Sheppard Mullin

## Proposed Changes to FAR Part 45 "To Add Clarity and Correction" to Government Property Provisions

Contractors handling Government property should be aware of upcoming changes to Federal Acquisition Regulation ("FAR") Part 45. Revisions to FAR 45 and other provisions relating to Government property were made throughout 2007 (*see* Federal Acquisition Circular 2005-17, FAR Case 2004-025) and continue with the August 6, 2009 proposed rule (*see* FAR Case 2008-011). The proposed rule is intended merely "to add clarity and correction" to the previously published final rule for Part 45, published May 15, 2007. However, contractors who must comply with Government property regulations must be alert to the implications of the rule change on the allocation of the risk of loss for Government property, requirements for contractor property management systems, and contractors' right to obtain profit on contractor-acquired property used in performance but not a deliverable under the contract.

### Allocation of Risk of Loss

The essential thrust of the provisions addressing risk of loss for Government property remains unchanged. Contractors continue to be liable for lost, damaged, destroyed or stolen Government property under contracts with progress payments based on costs or performance-based payments, as well as for fixed-price contracts with progress payments or performance-based payments. Likewise, contractors will not, as a general rule, be held responsible for lost, damaged, destroyed, or stolen Government property under cost reimbursement, time-and-material, and labor-hour type contracts or fixed-price contracts awarded on the basis of submission of cost or pricing data. *See* FAR 45.104. One key exception is where the contractor's property management practices are inadequate and it fails "to take timely corrective action." Then, only with "clear and convincing evidence" that the loss did not arise because of those inadequacies will the contractor be able to recover.

The proposed rule first addresses risk of loss with what appears to be primarily a stylistic change by revising the order of occurrences that give rise to liability, substituting the phrase "loss, theft, damage, or destruction" for the phrase "loss, damage, destruction, or theft." This change would occur over twenty times throughout the FAR and may be more than stylistic in that it emphasizes the possibility of theft over other occurrences.

Other proposed modifications that more likely have substantive implications on contractor risk

and liability are those relating to the definitions of "Government property" and "Government-furnished property." The proposed rule adds to the definitions by specifying certain categories of items that do and do not constitute Government or Government-furnished property.

"Government property" is currently defined as "all property owned or leased by the Government. . . [and] includes both Government-furnished property and contractor-acquired property." FAR 45.101. Contractor-acquired property is defined as "property acquired, fabricated, or otherwise provided by the contractor for performing a contract, and to which the Government has title." *Id.* The proposed rule adds another sentence to the definition of "Government property," expressly listing "material, equipment, special tooling, special test equipment, and real property" as items included within the scope of Government property. However, the amendment specifies that Government property does not include intellectual property and software.

"Government-furnished property" is presently defined as "property in the possession of, or directly acquired by, the Government and subsequently furnished to the contractor for performance of a contract." FAR 45.101. Under the proposed rule, the definition would specifically include "spares and property furnished for repair, maintenance, overhaul, or modification." While arguably not altering the basic understanding of the terms, these definitional changes make explicit the boundaries of the overlapping universes of Government property and Government-furnished property for which contractors are responsible, thereby at least precluding arguments that types of property previously not listed in the regulation are not Government or Government-furnished property.

### Contractor Property Management Systems

Under FAR Part 45, contractors are required to maintain property management systems that establish the contractor's processes for receiving, safeguarding, and disposing of Government property. These systems may be based on voluntary consensus standards or industry-leading practices and are overseen by and subject to the approval of a property administrator, who represents the contracting agency and is an authorized representative of the contracting officer. Contractors whose systems are in approved status benefit from the Government's assumption of the risk of loss, while failure by the contractor to maintain and/or timely correct any deficiencies in his property management system as directed by the property administrator could result in revocation of the Government's assumption of risk for loss under certain contracts or the exercise of other rights and remedies available to the contracting officer. FAR 45.105.

The proposed rule clarifies the requirements relating to contractor property management systems, but in the view of some commentators, these clarifications would impose unnecessary burdens on contractors. The proposed rule clearly gives property administrators additional criteria by which to judge the adequacy of contractor property systems and, implicitly, on which to base a decision to disapprove those systems.

Part 45.101, as proposed, sets forth a definition for "property records," a term previously used in the section but only now memorialized to mean "the records created and maintained by the contractor in support of its stewardship responsibilities for the management of Government property." The proposed rule provides that such records are to be appropriately safeguarded and

retained for four years.

Additionally, the proposed rule adds requirements for inventory disposal schedules, which contractors must maintain as part of their property records. In addition to existing requirements, the proposed rule suggests that the inventory disposal schedule identify the following:

- "For special tooling and special test equipment, each part number with which the item is used;"
- "For work-in-progress, the estimated percentage of completion;"
- "For precious metals, the type of metal and estimated weight;"
- "For hazardous material or property contaminated with hazardous material, the type of hazardous material;"
- "For metals in mill product form, the form, shape, treatment, hardness, temper, specification (commercial or Government) and dimensions (thickness, width and length);" and
- "Any additional information that may facilitate understanding of the property's intended use."

This list would be an addition to the Government Property clause at FAR Part 52.245-1(j)(3).

In order to ensure compliance with Government property administration requirements at subcontractor and prime contractor alternate locations, the property administrator may request support property administration from another contract administration office. Under the proposed rule, the property administrator would need consent from the prime contractor in order to gain access to subcontractor locations. The current FAR does not require consent, but instead requires the prime contractor to allow support property administration at subcontractor locations. *See* FAR 45.502. As in the present version of the FAR, the proposed rule does not require contractor consent when the request is for support delegations at prime contractor alternate locations.

### Disallowance of Profit

Perhaps the most controversial of the proposed revisions is FAR 15.404-4(a)(3), which would disallow profit on contractor-acquired property that is not a deliverable under the contract. Commentators suggest that the proposed change disallowing profit will remove contractors' incentive to perform at their maximum capabilities and may cause some contractors to engage in inefficient practices such as utilizing labor rather than acquiring more efficient equipment or charging contractor-acquired property to overhead instead of to the contract. These commentators also argue that the proposed revision could potentially give the Government reason to base its acceptance of delivery schedules on considerations of profit availability. Finally, commentators point out that reformatting existing database infrastructure to account for those items that would no longer be subject to profit is likely to be extremely costly for contractors.

In addition to those revisions mentioned above, the proposed rule would implement other minor

changes such as substituting the term "item unique identifier" for "unique-item identifier" in FAR 45.201, breaking out the existing requirements for certain types of scrap into a new section (c) in FAR 45.606-1, and rearranging the language of FAR 45.402 to clarify ownership interests in contractor-acquired property.

The extent to which the proposed changes to FAR Part 45 will affect contractor liability for Government property remains uncertain. However, proposed changes to key definitions, additional requirements for property management systems, and a new provision disallowing profit on some contractor-acquired property seem to suggest that these revision efforts do more than simply "clarify and correct" the May 2007 final rule.

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