LEGAL ASPECTS OF RENEGOTIATION*

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THE Renegotiation Act¹ which became effective April 28, 1942, was designed to eliminate and remove exorbitant profits from war contracts. No other recent statute has been the subject of so much controversy and misunderstanding.² Since the beginning of renegotiation of contracts in the late summer and early fall of 1942, policies have been crystalizing and many interpretations of the act have been made, but many more questions as to its meaning must still be answered.

It is not the intention to discuss here the economics of renegotiation, but rather to deal with the problems of law which it raises. Nevertheless, the background of the statute as well as a statement of the purposes of renegotiation and the organization for its administration are of importance to this discussion. Renegotiation is a method of profit limitation. As an instrument for the procurement of war material at fair prices, it arose from the idea that a limitation of profit on war contracts

* Any opinions set forth in this article are those of the author and are not official expressions of the War Department.

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A previous article by Major Steadman dealing with renegotiation appeared in the August issue of the Review; early publication is planned for a third article by this author on the same topic.—Ed.


was essential to promote the national morale and to prevent inflation. Some profit limitation measure became necessary because of the enormous size of the armament program which had to be set in motion with but little experience in the mass production of war goods and without reliable cost information. Under these circumstances little opportunity existed to gauge the fairness of prices. This resulted in the creation of excessive profits in many instances.

Renegotiation also came from a brand of thought which rested upon the concept that without an incentive to reduce costs, efficiency could not be promoted in the face of a high excess profits tax such as is necessary to finance war. The Vinson-Trammel Act, which preceded the Renegotiation Law as a profit limitation measure, provided for a fixed percentage of profit limitation. The proponents of renegotiation


7 The Vinson-Trammel Act originally provided for a limitation of profits on the construction of naval vessels and naval aircraft to ten per cent of the contract price. This limitation was altered in April, 1939, so that the ten per cent limitation applied only to naval vessels, and a profit of twelve per cent of the contract price became the limitation permitted for Army and Navy aircraft. The profit limitations were later
did not believe that a fixed percentage of profit limitation was satisfactory. Hence the Renegotiation Act delegates to the Secretaries of the War, Navy and Treasury Departments, to the Chairman of the Maritime Commission, and to the Boards of Directors of the Defense Plant Corporation, Metals Reserve Company, Defense Supplies Corporation and Rubber Reserve Company, the authority to determine what are excessive profits in relation to the individual producer and to eliminate them through recapture or reduction in contract prices, as provided in the statute.

At the time the law was passed, the Government's contracting officers were following the practice of requesting price reductions from contractors whenever it was found that the contract prices were too high. The obligation to procure war goods, which has been imposed upon the procurement agencies of the government, carries with it an obligation to procure at fair and reasonable prices. The Second War Powers Act gave contracting officers the right to inquire into contract costs and such inquiries were being made. But Congress believed that something more was required—thus renegotiation.

Administrative Organization. The task of administering the Renegotiation Act is a vast undertaking. It is estimated that there are about 25,000 companies within the scope of the law as presently

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9 Section 1, Act of July 1, 1943, Pub. L. 108, 78th Cong., 1st sess., amended The Renegotiation Act, subsec. 403(a) and added subsec. (k) so as to include contracts with the Defense Plant Corporation, Metals Reserve Company, Defense Supplies Corporation, and Rubber Reserve Company within the scope of this law. Prior to this time contracts and subcontracts with these four subsidiaries of Reconstruction Finance Corporation were not subject to renegotiation. The text of this latest amendment reads as follows:

"Provided further, That clauses (1) and (2) of subsection (a) of section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended, are amended to read as follows:

"Sec. 403 (a) For the purposes of this section—

"1. The term 'Department' means the War Department, the Navy Department, the Treasury Department, the Maritime Commission, Defense Plant Corporation, Metals Reserve Company, Defense Supplies Corporation, and Rubber Reserve Company, respectively."


11 This was being carried on pursuant to Executive Order No. 9217, signed April 10, 1942, issued under the Second War Powers Act, 1942, Pub. L. 507, 77th Cong., 2d sess., approved March 27, 1942, 56 Stat. L. 176.
The departments decided to handle this job through the use of their existing organizations with the addition of what are known as Price Adjustment Boards which would be a part of the departments' procurement branches or associated with those branches. It was thought that the act would be administered best if the boards were selected from the professions and business, so that they would be composed of men conversant with industrial and business problems.

The War Department organized in Washington the War Department Price Adjustment Board. This is the central board for coordinating and determining the renegotiation policies within that department. This board handles directly very few cases. Following the establishment of the War Department Price Adjustment Board the Undersecretary of War directed that authority be delegated to the Commanding General of the Army Service Forces, then Headquarters Services of Supply and to the Army Air Force Materiel Command, and

12 Mr. Maurice Karker, Chairman, War Department Price Adjustment Board, in Hearings before the House Naval Affairs Committee, 78th Cong., 1st sess., pursuant to H. Res. 30, p. 1004, June 30, 1943, stated that the total number of contracts and subcontracts subject to renegotiation "will probably not exceed 25,000 and that the figure may even be substantially less." An estimate made by the Truman Committee (see Report of Special Committee investigating the National Defense Program, 78th Cong., 1st sess., S. Rep. No. 10, part 5, p. 7) placed the number of contractors subject to the act at 85,000. Mr. Karker points out, however, in Hearings before the House Naval Affairs Committee, 78th Cong., 1st sess., pursuant to H. Res. 30, at p. 1004, that:

"It is understood that only approximately 85,000 names are listed in Thomas' Register of Manufacturers which purports to include all of the manufacturing companies in the United States with any substantial production. Inquiry discloses that the records of the Department of Commerce indicate that there are 85,000 contracts of more than $50,000, and the Statistics Division of the War Production Board has stated that these contracts are being performed in 13,700 plants. 1939 Census of Manufacturers shows only 95,187 manufacturing corporations then having annual sales in excess of even the low volume of $5,000. The Internal Revenue Bureau estimates that there are approximately 86,000 manufacturing concerns in the country, and that 40,00 to 50,000 of these have annual sales of less than $100,000."


14 The statute provides that the authority and discretion conferred upon the secretary of each department named "may be delegated, in whole or in part, by him to such individuals or agencies" as he may designate in his department or in any other department with the consent of the secretary of that department, and he may authorize such individuals or agencies to make further delegation of such authority and discretion.

in turn these services were directed to establish price adjustment boards and sections throughout the organization for the administration of the law. The renegotiation activities of the Army Service Forces in being conducted through the various branches of that service are largely on a decentralized basis. This is also true, but to a somewhat lesser degree, with the Army Air Force Materiel Command.

At the same time that the War Department Price Adjustment Board was organized, the Navy Department set up a Navy Department Price Adjustment Board which is the Navy's central board and has its headquarters in Washington. This board not only determines policy but directly handles cases. In fact the majority of the cases in the Navy Department were dealt with originally by this board. Recently, however, the Navy has undertaken some decentralization of activities and established boards in New York, Chicago and San Francisco. The Price Adjustment Boards of the Maritime Commission and the Treasury Department are similar in nature and have centralized their activities in Washington. The War Shipping Administration has also set up a price adjustment procedure for renegotiation of contracts.\(^{15}\)

The four subsidiaries of the R. F. C. which have recently been given renegotiating authority have now established a board in Washington for conducting renegotiation.

*How a Case is Handled.* The function of the renegotiation boards is

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\(^{15}\) The War Shipping Administration derives its legal authority for the establishment of the War Shipping Administration Price Adjustment Board and the exercise of authority under the Renegotiation Act from certain Executive Orders establishing the War Shipping Administration as well as from the act itself. Executive Order No. 9054, dated February 7, 1942, established the War Shipping Administration. This Executive Order was amended by Executive Order 9244, dated September 16, 1942, the purpose of which was to clarify the functions and duties of the War Shipping Administration. The functions that had been performed by the War Shipping Administration prior to its being constituted as a separate branch of the Executive Department within the office of Emergency Management had been performed by the Maritime Commission under powers given it. One of the functions of the Maritime Commission specifically transferred to the War Shipping Administration by Executive Order 9054 were the activities and functions, duties and powers conferred upon the Maritime Commission by § 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, Pub. L. 528, 77th Cong., 2d sess., 56 Stat. L. 226. The activities of the Maritime Commission which were transferred to the War Shipping Administration upon its establishment by authority of title I of the First War Powers Act of 1941, Pub. L. 354, 77th Cong., 1st sess., 55 Stat. L. 838, which authorizes the President to transfer any duties or powers from one existing department to another branch or agency. With respect to this matter see the Opinion of the General Counsel of the War Shipping Administration under date of June 26, 1943 relative to the authority for the establishment of the War Shipping Administration Price Adjustment Board.
to review the prices and profits of those companies that are assigned to them. The company or producer, generally referred to as the contractor, is ordinarily assigned for renegotiation to that department and to the branch within that department with which it does the greatest amount of its business. For example, if a contractor does the preponderance of his business with the Ordnance Department, which is a part of the Army Service Forces and a branch of the War Department, he will be assigned to an Ordnance District Price Adjustment Board for renegotiation. That board will then conduct renegotiation for all the other departments and services concerned. This is under an agreement between the various secretaries.\textsuperscript{16}

After a contractor is assigned to one of the boards, he is notified and is asked to submit certain financial information, as well as data concerning sales for the fiscal year being considered. Profits from those sales and statements which will reflect the general efficiency of the contractor's operations, as well as the risk which he has assumed, are also requested. It should be remembered that even though renegotiation is conducted on an overall basis in that all of the contractor's contracts are considered as a group,\textsuperscript{17} in reality the search is made into the fairness of the contractor's prices. Profits are examined as a short-cut to determine fair prices, it being the concept of the act that if profits are exorbitant prices are too high.

The information submitted by the contractor is studied carefully. Although audits are seldom conducted, the contractor must be able to support his statements with facts and figures. The data which he submits for renegotiation is his representation and not that of the Government. The contractor must be especially careful that the data which he submits is accurate. If the statement of his earnings is based upon estimates it should be disclosed as an estimate, and the method of making such estimates should be carefully stated; otherwise the contractor may be in the position of making misrepresentations to the Government and encounter penalties specified in subsection (e) of the Renegotiation Act.\textsuperscript{18}

\textsuperscript{16} Delegation of authority pursuant to subsec. (f) of § 403, January 19, 1943.
\textsuperscript{17} Subsection (e) (1) of § 403.
\textsuperscript{18} Subsection (e) of § 403, 56. Stat. L. 226 at 246, provides:
"(e) In addition to the powers conferred by existing law, the Secretary of each Department shall have the right to demand of any contractor who holds contracts with respect to which the provisions of this section are applicable in an aggregate amount in excess of $100,000, statements of actual costs of production and such other financial statements, at such times and in such form and detail, as such Secretary may require."
After this information is analyzed, the contractor is asked to confer with the board to which he has been assigned or its representatives. Thereafter the board makes a determination as to whether there are present in the company's earnings what the statute calls "excessive profits." If such profits do exist the board either takes action to eliminate them or recommends to the responsible officials what profit limitation should be imposed upon such earnings for the fiscal year which has been under consideration. The board undertakes to negotiate an agreement with the contractor embodying the terms of its findings. The agreement may call for a refund if it is determined that the profits are excessive, or it may grant the contractor a clearance for the fiscal year which has been renegotiated if it is found that the profits are not excessive. These agreements are final and constitute a binding undertaking on the part of the Government and the contractor.

**THEORY OF THE LAW**

The statute declares a policy against the creation and retention of excessive or exorbitant profits derived from high prices in war contracts. It contemplates that these excessive profits shall be determined and eliminated through the exercise of administrative discretion. Admittedly, if this were a tax statute, a law designed to raise revenue for the United States, as it has frequently though erroneously been thought to be, the Renegotiation Law would have introduced a new theory for the determination of excess profits. But this is not a tax statute. It is a law concerned with the problems of profit limitation, problems of "excessive profits." Its primary function is not to raise revenue but to implement the procurement activities of the Government. Congress adverted to the possibility of accomplishing this aim through taxation and rejected this method. Any person who wilfully fails or refuses to furnish any statement required of him under this subsection, or who knowingly furnishes any such statement containing information which is false or misleading in any material respect, shall, upon conviction thereof, be punished by a fine of not more than $10,000 or imprisonment for not more than two years, or both. The powers conferred by this subsection shall be exercised in the case of any contractor by the Secretary of the Department holding the largest amount of such contracts with such contractor, or by such Secretary as may be mutually agreed to by the Secretaries concerned. 


The act created no objective formula for determining excessive profits. It has been contended that no formula should govern in as much as a formula would prevent the consideration of the varying and different circumstances under which producers operate. The flexibility of the law is said to make possible its fair application. The statute prescribes the standard of reasonableness in the determination of what is fair and the determination of what is a fair profit and what is an excessive profit is left to administrative decision.

**Constitutional Issues**

No one disagrees with the proposition that excessive profits ought to be eliminated from war contracts. As a matter of law, however, the question raised is whether Congress has selected a constitutional means for achieving this end. The answer appears to lie primarily in issues of impairment of contractual obligations.

*Impairment of Obligations of Contracts.* The first problem arising in this regard is whether the law impairs the obligation of contracts. This question breaks itself into three distinct facets in relation to (a) contracts entered into after the passage of the statute which contain the so-called renegotiation clause, (b) those contracts entered into after the passage of the statute which do not contain such a clause and (c) contracts in effect before passage of the statute.

Virtually all prime and subcontracts entered into after the passage of the statute contain a clause providing for renegotiation as directed by the act. The parties having agreed to renegotiate, there appears no doubt as to the right of the Government to enforce the agreement in these contracts. But contracts undoubtedly have been made, after the act became effective, which do not contain the renegotiation clause. Contracts entered into directly or indirectly with the departments covered by the law are subject to renegotiation whether incorporating a renegotiation clause or not, for the provisions of the Renegotiation Act make it effective with regard to all such contracts. The doctrine of adoption of existing law into a contract is wholly applicable here. The parties having made their contracts after the passage of the law which purports to affect such agreements, must have included the purport of

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22 Subsection (c) (6) of § 403, as amended.

2741-3. For similar points of view see Patterson, Robert P., id., March 19, 1942, p. 2479; Nelson, Donald M., id., March 24, 1942, p. 2614; Ball, Joseph H., April 7, 1942, in 88 CONG. REC. 3395-3396.
such statute in their undertakings. The right to renegotiate becomes one of the terms of the contract and this would be true whether the parties knew the United States had such a right or not. In *College Point Boat Corporation v. United States,* the United States Supreme Court affirmed this position. There the claimant and the Navy Department had made a contract for the delivery of mats. After the Armistice was signed, the Navy told the company that the mats would probably not be needed and suggested that it cease manufacturing these items. The company was asked to submit a proposal for the cancellation of the contract, which had been made after the passage of a statute which contained a provision giving the United States the right to cancel contracts. In holding that the stoppage of performance was an anticipatory breach, the Court in an opinion by Mr. Justice Brandeis said:

"...The United States actually did have an unconditional right of cancellation. For the contract was made pursuant to the Act of June 15, 1917, c. 29, 40 Stat. 182. By virtue of the statutory provision as was later held in *Russell Motor Co. v. United States,* 261 U. S. 514, the right to cancel became, by implication, one of the terms of the contract. But, so far as appears, neither party knew that the United States had such a right...."

As applied to the question at hand it seems difficult to support any position other than the one arrived at by the Court. Even though the adoption of the statute into the contract may involve a fiction, reasons of public interest seem to outweigh any suggestion that would make it possible to contract away the policy as declared by Congress, designed for the protection of the general public and especially to forward the prosecution of the war.

*Is the Act Unconstitutional as Applied to Contracts Entered Into Prior to its Effective Date, April 28, 1942?* It seems quite clear that the war powers of Congress are sufficiently broad to permit the constitutional enactment of the Renegotiation Law. This is patently true in view of the critical effect of prices on domestic morale and expanded

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25 Id. at p. 15. Cf. 3 WILLISTON, CONTRACTS, rev. ed., § 615, note 13 (1936).
26 267 U. S. 12, 45 S. Ct. 199 (1925).
production caused by modern war. That the act is constitutional with regard to its powers and scope, in general, does not, however, automatically make it immune from attack on constitutional grounds in specific cases. Here a question arises as to whether the Renegotiation Act may be constitutionally applied to contracts that were in existence at the time it became effective. The act attempts to gather under its cloak not only all contracts made after its passage but also those made before its enactment where final payment had not been made.28

The case of Norman v. Baltimore & Ohio Ry. Co., 29 made it perfectly clear that private parties cannot prohibit Congress from the exercise of a power having to do with the accomplishment of an instrument of national policy. Speaking through Mr. Chief Justice Hughes, the Court said, "There is no constitutional ground for denying to the Congress the power expressly to prohibit and invalidate contracts although previously made, and valid when made, when they interfere with the carrying out of the policy it is free to adopt." 30 The Court, in this case, it will be remembered, was dealing with the application of the statute which prohibited payment of obligations in gold. 31 The railroad had agreed to pay its bonds in gold coin of given weight and fineness. The contract obtained as between private individuals. The court decided

28 Subsection (c) (6) of § 403, as amended. The Joint Statement of the War, Navy and Treasury Departments and the Maritime Commission of Purposes, Principles, Policies, and Interpretations of § 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, Pub. L. 528, 77th Cong., 2d sess., approved April 28, 1942, as amended, published March 31, 1942 by the United States Government Printing Office, has been revised in relation to § J-PAB-2(a), to read as follows:

"The Departments have adopted the policy that final payment will be considered to have been made prior to April 28, 1942, if full payment has been made except for amounts withheld with respect to performance guarantees, penalties, performance bonuses, (or small disputed items), but if any other amount is unpaid as of April 28, 1942, irrespective of the size of the amount so unpaid or the reasons for nonpayment, the entire contract shall be deemed subject to renegotiation although the amount of the payment due as of April 28, 1942, and the circumstances, if any, relating to the delay in payment will be given full consideration in determining the amount of excessive profits."

The counsel for the Reconstruction Finance Corporation has interpreted the recent amendment to § 403, which made subject to the act contracts and subcontracts with the Defense Plant Corporation, Metals Reserve Company, Defense Supplies Corporation, and Rubber Reserve Company (§ 1, Act of July, 1943, Pub. L. 108, 78th Cong., 1st sess.) to be retroactive. Thus, under this ruling all contracts and subcontracts with these agencies upon which final payment was not made on or before April 28, 1942, are also subject to the act.

that the powers of Congress are sufficiently great to permit the impairment of these contractual obligations. This position was taken in full view of the Fifth Amendment which forbids the abridgement of property rights and hence contract rights without due process of law.\textsuperscript{82}

In \textit{Perry v. United States},\textsuperscript{83} another gold clause case,\textsuperscript{84} the holder of a Liberty Bond, issued when gold was in circulation and at a standard value of a certain weight and fineness, claimed payment in accordance with the promise set forth in the bond. Pursuant to legislation, the Government had, however, withdrawn all gold coin from circulation, prohibited with certain limited exceptions its export or use in foreign exchange, reduced the weight of gold which represented the standard dollar, and placed all forms of money on a parity with that standard. By joint resolution in 1933, Congress declared that such bonds could be discharged by payment, dollar for dollar, in any coin or currency which was legal tender for public and private debts. The bondholder, Perry, demanded currency in an amount exceeding the face of the bond in the same ratio as that borne by the number of grains in the former gold dollar to the number in the existing one. He was refused payment in gold coin of the former standard or in an equal weight of gold, and the Treasury declined to pay him more than the face of the bond in currency. He then brought an action in the Court of Claims, and although the court decided that the repudiation by the Government of the gold clause in the bond was an unconstitutional exercise of congressional authority, the plaintiff could not recover more than the loss he had actually suffered. Since Perry was unable to show any actual damage, he was denied recovery. The Court, in holding the joint resolution, as applied to the Government obligations, unconstitutional,\textsuperscript{85} gave

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\item \textsuperscript{83} 294 U. S. 330, 55 S. Ct. 432 (1935).
\item \textsuperscript{84} Beside the Norman and Perry cases the other Gold Clause Cases were United States v. Bankers Trust Co., 294 U.S. 240, 55 S. Ct. 407 (1935); Nortz v. United States, 294 U. S. 317, 55 S. Ct. 428 (1935). All but the Perry case reached the result of the Norman case.
\item \textsuperscript{85} The Court in Perry v. United States, 294 U.S. 330 (1935), through Mr. Justice Hughes said at pages 350 and 351:
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... The Government's contention thus raises a question of far greater importance than the particular claim of the plaintiff. On that reasoning, if the terms of the Government's bond as to the standard of payment can be repudiated, it inevitably follows
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further impetus to the conception that while the Federal Government may be able to impair the obligations of contracts as between private individuals, as in the *Norman* case, no such power obtains with reference to obligations of the United States. Now, it is important to note this distinction, for, if it is sound in its application to the Renegotiation Act, a distinction immediately arises as to the effect of the statute upon prime contracts between the Government and the contractor on the one hand, and subcontracts between two private persons on the other. Certainly the act intended no such distinction, for it specifically defines a "contract" as including subcontracts.

The difficult question is whether the decisions of the Court compel prime contracts in this category to be treated differently than subcontracts. At the time that the *Perry* case was decided it had not been determined that the contractual obligations of the United States were not subject to regulation by Congress under some circumstances. It seems that the obligation as to the amount to be paid may also be repudiated. The contention necessarily imports that the Congress can disregard the obligations of the Government at its discretion and that, when the Government borrows money, the credit of the United States is an illusory pledge.

"We do not so read the Constitution. There is a clear distinction between the power of the Congress to control or interdict the contracts of private parties when they interfere with the exercise of its constitutional authority, and the power of the Congress to alter or repudiate the substance of its own engagements when it has borrowed money under the authority which the Constitution confers. In authorizing the Congress to borrow money, the Constitution empowers the Congress to fix the amount to be borrowed and the terms of payment. By virtue of the power to borrow money 'on the credit of the United States,' the Congress is authorized to pledge that credit as an assurance of payment as stipulated,—as the highest assurance the Government can give, its plighted faith. To say that the Congress may withdraw or ignore that pledge, is to assume that the Constitution contemplates a vain promise, a pledge having no other sanction than the pleasure and convenience of the pledgor. This Court has given no sanction to such a conception of the obligations of our Government." (Italics are the Court's).

86 *Sinking Fund Cases*, 99 U.S. 700 at 718-719 (1878); *United States v. Central Pacific R.R. Co.*, 118 U.S. 235 at 238, 6 S. Ct. 1038 (1886); *United States v. Northern Pacific Ry Co.*, 256 U.S. 51 at 64, 41 S. Ct. 439 (1921); and *Lynch v. United States*, 292 U.S. 571, 54 S. Ct. 840 (1934); all adhere to this idea. This seems to have had its beginning in such cases as *Calder v. Bull*, 3 Dall. (3 U.S.) 386 (1798), involving a private contract; *The Floyd Acceptances*, 7 Wall. (74 U.S.) 666 at 675, (1868); *Hepburn v. Griswold*, 8 Wall. (75 U.S.) 603 (1869); *Cooke v. United States*, 91 U.S. 389 at 396 (1875). Cf.: *State Tax and Foreign Held Bonds*, 15 Wall. (82 U.S.) 300 at 320 (1872).

87 Subsection (a) (5) of § 403, as amended.

88 Mr. Chief Justice Hughes stated his opinion as though the case involved the question of whether the contractual obligations of the United States can be completely abrogated. He said in 294 U.S. 330 at 350 (1935):

"... The Government's contention thus raises a question of far greater importance
unlikely that the Perry case decided this question. The holding there appears to be narrowly limited to situations wherein the credit of the United States has been pledged for money borrowed. Despite the fact that there is much broad language in the decision a careful review of the case reveals that the only question before the Court was the regulation by Congress of the use of gold currency in the payment of gold bonds issued prior to the Joint Resolution. Apart from that there was no default by the United States. The Perry decision moves to its conclusion because of the Court's reluctance to permit Congress to repudiate a pledge of credit since the borrowing of money was involved. The limitation upon the doctrine expressed in the majority opinion by Mr. Chief Justice Hughes becomes even more pronounced when viewed in the light of the concurring opinion of the present Chief Justice who not only took the position that Perry should not recover because he had not suffered any loss but also argued that the Court should not commit itself to any proposition under which Congress could not impair its own commitments whether for credit or otherwise.

than the particular claim of the plaintiff. On that reasoning, if the terms of the Government's bond as to the standard of payment can be repudiated, it inevitably follows that the obligation as to the amount to be paid may also be repudiated. The contention necessarily imports that the Congress can disregard the obligations of the Government at its discretion, and that, when the Government borrows money, the credit of the United States is an illusory pledge.

For example at page 353 of the Perry case, 294 U.S. 330 (1935), the Court said:

"... The powers conferred upon the Congress are harmonious. The Constitution gives to the Congress the power to borrow money on the credit of the United States, an unqualified power, a power vital to the Government—upon which in an extremity its very life may depend. The binding quality of the promise of the United States is of the essence of the credit which is so pledged. Having this power to authorize the issue of definite obligations for the payment of money borrowed, the Congress has not been vested with authority to alter or destroy those obligations. The fact that the United States may not be sued without its consent is a matter of procedure which does not affect the legal and binding character of its contracts. While the Congress is under no duty to provide remedies through the courts, the contractual obligation still exists and, despite infirmities of procedure, remains binding upon the conscience of the sovereign. Lynch v. United States, supra, pp. 580, 582."

For an interesting discussion upon the power of Congress to regulate the obligations of the United States in reference to the gold clause in United States bonds see Hart, "The Gold Clause in U.S. Bonds," 48 Harv. L. Rev. 1057, 1069 (1935).

Mr. Justice Stone in his concurring opinion said (294 U.S. at 359):

"I do not understand the Government to contend that it is any the less bound by the obligation than a private individual would be, or that it is free to disregard it except in the exercise of the constitutional power 'to coin money' and 'regulate the value thereof.' In any case, there is before us no question of default apart from the regulation by Congress of the use of gold as currency."

See note 39 supra.

In the case of Perry v. United States, 294 U.S. 330, 55 S. Ct. 432 (1935), Mr. Justice Stone said at pp. 359 and 361:
Perry case, the Sinking Fund Cases, United States v. Central Pacific Ry Co., Lynch v. United States, and others of this group rest upon the underlying rationale that once the credit of the United States has been pledged, Congress is without power to interfere with the obligation because if Congress is permitted to withdraw the pledge of the United States such action would impair the ability of the Government to conduct its affairs by destroying the confidence of the people in the Government's undertakings. Certainly this is the paramount basis for the Perry decision. It is upon this reasoning that these cases are encompassed by the Fifth Amendment. If this is their true basis, however, were it not for the unusual circumstances of war, it would seem that the public confidence would be as much destroyed by the Government's disregarding its obligations under war contracts.

Unless it can be assumed that that canon of constitutional decision which forbids the determination of a constitutional question upon facts not presented for judgment is no longer part of our constitutional paraphernalia, neither the Perry case nor those cases following the Sinking Fund Cases are binding precedents in this inquiry since they...

"In this posture of the case it is unnecessary, and I think undesirable, for the Court to undertake to say that the obligation of the gold clause in Government bonds is greater than in the bonds of private individuals, or that in some situation not described, and in some manner and in some measure undefined, it has imposed restrictions upon the future exercise of the power to regulate the currency. I am not persuaded that we should needlessly intimate any opinion which implies that the obligation may so operate, for example, as to interpose a serious obstacle to the adoption of measures for stabilization of the dollar, should Congress think it wise to accomplish that purpose by resumption of gold payments, in dollars of the present or any other gold content less than that specified in the gold clause, and by the re-establishment of a free market for gold and its free exportation....

"I therefore do not join in so much of the opinion as may be taken to suggest that the exercise of the sovereign power to borrow money on credit, which does not override the sovereign immunity from suit, may nevertheless preclude or impede the exercise of another sovereign power, to regulate the value of money; or to suggest that although there is and can be no present cause of action upon the repudiated gold clause, its obligation is nevertheless, in some manner and to some extent, not stated, superior to the power to regulate the currency which we now hold to be superior to the obligation of the bonds."

99 U.S. 700 at 718-719 (1878).
118 U.S. 235 at 238, 6 S. Ct. 1038 (1886).


99 U.S. 700 at 718-719 (1878).
do not involve circumstances of war. Nor do any of these decisions hold that there are no instances in which Congress is not empowered to exercise its regulatory powers in such a way as it deems necessary for the protection of the public interest. They do not decide that it may not become more important to permit the free exercise of these regulatory powers than to require the "punctilious fulfillment of contractual obligations." If this analysis is correct then it would seem that Congress is not prohibited from regulating the contracts of the Federal Government in time of war for the purpose of controlling profits and restraining prices in the procurement of war material. At least this would appear to be an open question.

There are profound difficulties that accompany any contention that war circumstances are insufficient to permit the constitutional application of renegotiation to contracts of the Federal Government which were extant at the time the act was passed. Indeed, when *Lynch v. United States* was decided the Court speaking through Mr. Justice Brandeis recognized that there were situations to which the protection of the Fifth Amendment which normally might hold inviolate the contractual obligations of the Government, could not be extended. The Court said (p. 579):

"Second. The Fifth Amendment commands that property be not taken without making just compensation. Valid contracts are property, whether the obligor be a private individual, a municipality, a State or the United States. Rights against the United States arising out of a contract with it are protected by the Fifth Amendment. *United States v. Central Pacific R. Co.*, 118 U.S. 235, 238; *United States v. Northern Pacific Ry. Co.*, 256 U.S. 51, 64, 67. When the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals. That the contracts of war risk insurance were valid when made is not questioned. As Congress had the power to authorize the Bureau of War Risk Insurance to issue them, the due process clause prohibits the United States from annulling them, unless, indeed, the action taken falls within the federal policy power of some other paramount power."

(Underscoring supplied).

No better illustration of a situation where the action taken falls within "some other paramount power" is needed than that found in the *Legal Tender Cases* which arose out of the Civil War. It is true

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42-i *Ibid*.
that those cases involved an interference by the Federal Government with private contracts—debts incurred by private contracting parties prior to the passage of the Legal Tender Acts. Nonetheless, *Knox v. Lee* and *Parker v. Davis*, in overruling *Hepburn v. Griswold* were as great a departure, if not a greater departure from prior precedent than the Renegotiation Act and they are clearly illustrative of the enormous power conferred upon Congress in order to maintain a war economy.

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42-k 12 Stat. L. 345, 532, 709 (1862-1863).
42-1 8 Wall. (75 U.S.) 603 (1869).
42-m Mr. Justice Strong rendering the majority opinion for the Court in the Legal Tender Case, 12 Wall. (70 U.S.) 475 at 540-541 (1870), said:

"We do not propose to dilate at length upon the circumstances in which the country was placed, when Congress attempted to make treasury notes a legal tender. They are of too recent occurrence to justify enlarged description. Suffice it to say that a civil war was then raging which seriously threatened the overthrow of the government and the destruction of the Constitution itself. It demanded the equipment and support of large armies and navies, and the employment of money to an extent beyond the capacity of all ordinary sources of supply. Meanwhile the public treasury was nearly empty, and the credit of the government, if not stretched to its utmost tension, had become nearly exhausted. Moneyed institutions had advanced largely of their means, and more could not be expected of them. They had been compelled to suspend specie payments. Taxation was inadequate to pay even the interest on the debt already incurred, and it was impossible to await the income of additional taxes. The necessity was immediate and pressing. The army was unpaid. There was then due to the soldiers in the field nearly a score of millions of dollars. The requisitions from the War and Navy Departments for supplies exceeded fifty millions, and the current expenditure was over one million per day. The entire amount of coin in the country, including that in private hands, as well as that in banking institutions, was insufficient to supply the need of the government three months, had it all been poured into the treasury. Foreign credit we had none. We say nothing of the overhanging paralysis of trade, and of business generally, which threatened loss of confidence in the ability of the government to maintain its continued existence, and therewith the complete destruction of all remaining national credit."

At pages 550-551 he said:

"If, then, the legal tender acts were justly chargeable with impairing contract obligations, they would not, for that reason, be forbidden, unless a different rule is to be applied to them from that which has hitherto prevailed in the construction of other powers granted by the fundamental law. But, as already intimated, the objection misapprehends the nature and extent of the contract obligation spoken of in the Constitution. As in a state of civil society property of a citizen or subject is ownership, subject to the lawful demands of the sovereign, so contracts must be understood as made in reference to the possible exercise of the rightful authority of the government, and no obligation of a contract can extend to the defeat of legitimate government authority."

Mr. Justice Bradley, concurring, said at page 567:

"I do not say that it is a war power, or that it is only to be called into exercise in time of war; for other public exigencies may arise in the history of a nation which may make it expedient and imperative to exercise it. But of the occasions when, and of the times how long, it shall be exercised and in force, it is for the legislative department of the government to judge. Feeling sensibly the judgments and wishes of the people,
Here in the instance of the application of renegotiation to contracts existing at the time the act was passed, it is believed that the Court would be very reluctant to overlook the fact that lack of experience in the production of war goods and the constant experimentation resulting from changes arising from battle experience makes it extraordinarily difficult to achieve fair prices at the outset of any negotiation for war contracts and that the procurement of war goods at fair and reasonable prices are of vital importance to the security of the nation at war. Since the Court has recently said that equity is not sufficient to save the Government from the payment of exorbitant prices but recourse must be had to statute, it is not likely that it will disregard the need for that department cannot long (if it is proper to suppose that within its sphere it ever can) misunderstand the business interests and just rights of the community."

United States v. Bethlehem Steel Corporation, 315 U.S. 289, 62 S. Ct. 722 (1942). The Court decided that the allegations of the Government were not supported by evidence. Mr. Justice Black who rendered the opinion for the majority of the Court said at p. 309:

"The problem of war profits is not new. In this country, every war we have engaged in has provided opportunities for profiteering and they have been too often scandalously seized. See Hearings before the House Committee on Military Affairs on H.R. 3 and H.R. 5293, 74th Congress, 1st Sess., 590-598. To meet this recurrent evil, Congress has at times taken various measures. It has authorized price fixing. It has placed a fixed limit on profits, or has recaptured high profits through taxation, It has expressly reserved for the Government the right to cancel contracts after they have been made. Pursuant to Congressional authority, the Government has requisitioned existing production facilities or itself built and operated new ones to provide needed war materials. It may be that one or some or all of these measures should be utilized more comprehensively, or that still other measures must be devised. But if the Executive is in need of additional laws by which to protect the nation against war profiteering, the Constitution has given to Congress, not to this Court, the power to make them."

Mr. Justice Frankfurter dissented, saying at p. 330:

"To deny the existence of duress in a Government contract by ironic reference to the feebleness of the United States as against the overpowering strength of a single private corporation is an indulgence of rhetoric in disregard of fact. The United States with all its might and majesty never makes a contract. To speak of a contract by the United States is to employ an abstraction. We must not allow it to become a blinding abstraction. Contracts are made not by 130 million Americans but by some official on their behalf. Because the national interest is represented not by the power of the nation but by an individual professing to exercise authority of vast consequence to the nation, action by Government officials is often not binding against the Government in situations where private parties would be bound. The contracts here were not made by an abstraction known as the United States or by the millions of its citizens. For all practical purposes, the arrangement was entered into by two persons, Bowles and Radford. And it was entered into by them against their better judgment because they had only Hobson's choice—which is no choice. They had no choice in view of the circumstances which subordinated them and by which they were governed, namely, that ships were needed, and needed quickly, and Bethlehem was needed to construct them quickly. The legal alternative—that the Government take over Bethlehem—was not an actual alternative, and Bethlehem knew this as well as the representatives of the Government..."
such an instrument in the procurement of war goods.  

**Effect of Unconstitutionality Upon Renegotiation Clauses in War Contracts.** In as much as the renegotiation clause has been inserted in contracts at the direction of the statute, there may be some question as to whether it would be binding upon the parties in the event the act itself were declared unconstitutional. The courts have made many statements to the effect that a statute once having been found to be unconstitutional, is, for all effects and purposes, wholly inoperative, conferring no rights and imposing no duties.  

An interesting and pertinent case is *Cleveland v. Clement Bros. Construction Co.* This was an action brought against the city upon a contract for money due for work done and materials furnished. The city, in defending the action, undertook to justify the retention of the amount sued for through a provision that had been inserted in the contract under a statute which provided for eight hour work upon public works. The contract provision penalized the violation of the statute by a forfeiture of ten dollars for each man worked in a single day for more than eight hours when there was no emergency. The plaintiff had on one day worked thirty-two men for more than eight hours when there was no emergency. The defendant's answer was demurred to. The trial

At p. 334 he continued as follows:

"Authority given to make contracts does not imply authority to make unconscionable contracts. Suppose that Congress in authorizing the contracts in question had written into its legislation: 'Provided, that no agency of government shall be authorized to enter into unconscionable contracts.' Can it be that because Congress did not expressly provide that 'unconscionable contracts' are unauthorized it impliedly sanctioned the making of 'unconscionable contracts'? Or suppose the estimated costs in the contracts were so inflated by Bethlehem that its profits were 200% rather than 22%. Would this Court still be bound to enforce these contracts on the ground that Congress had commanded their enforcement? Surely, Congress did not impliedly repeal historic legal principles and prohibit this Court from exercising its duty to withhold relief when the particular circumstances disclose an unconscionable arrangement in the making of which the Government's contracting officers had no practical choice."

At p. 336:

"... During wartime the bargaining position of Government contracting officers is inherently weak, no matter how conscientious they may be." (Italics the Court's).

All of the major powers have found it necessary to institute various means of price control. For survey of foreign price control measures see *Hearings before the House Committee on Banking and Currency, 77th Cong., 1st sess. on H.R. 5479 (Price Control Bill), superseded by H.R. 5990, Part I, p. 88.* See also, *Patterson, "Renegotiation, What It Is, What It Does, How It Works," DUN'S REVIEW, January 1943, pp. 11-12.*


court overruled the demurrer. On appeal to the circuit court, the
judgment was reversed, and the Supreme Court affirmed this decision.
The Court held the eight-hour law unconstitutional and stated that
when a statute is declared unconstitutional, stipulations and agreements
required by the statute to be inserted in a contract have no obligatory or
binding force on the parties. But the better rule appears to be that even
though a clause is inserted in a contract at the direction of a statute
which is later declared to be unconstitutional, the parties are none the
less bound by their agreement if the contract is not defective for some
other reason and is not itself opposed to public policy. In these cases the
contracts are "upheld generally on the ground of a so-called estoppel."

The necessary conclusion seems to be that an agreement to renego­
tiate which is required in Government supply contracts would remain
in full force even though the statute were declared unconstitutional.
The only ground upon which this position would become unsound,
other than for some fault in the agreement itself, would be that the

45 5 Williston, Contracts, rev. ed., § 1588 (1936); Chicot County Dis­
U.S. 415 (1880); Booth Fisheries v. Industrial Commission of Wisconsin, 271 U.S.
208, 46 S. Ct. 491 (1926). On the analogy of payments made under Renegotiation
the payment of taxes or assessments voluntarily made under an unconstitutional tax
statute, recovery of any amount voluntarily paid in renegotiation would probably be de­
nied. Carr v. City of Memphis, (C.C.A. 6th, 1927) 22 F. (2d) 678; Yates v. Royal
4 F. (2d) 808; Field, "The Recovery of Illegal and Unconstitutional Taxes," 45
Harv. L. Rev. 501 (1932); but cf. Cloister Printing Corp. v. United States, (C.C.A.
2d, 1938) 100 F. (2d) 355 approved in a note in 52 Harv. L. Rev. 696 (1939).
In Chicot County District v. Bank, 308 U.S. 371 at 374 (1940), this statement is
significant:

"The courts below have proceeded on the theory that the Act of Congress 'having
been found to be unconstitutional was not a law; that it was inoperative, conferring no
rights and imposing no duties. . . . It is quite clear, however, that such broad statements
as to the effect of a determination of unconstitutionality must be taken with qualifica­
tions. The actual existence of a statute, prior to such a determination, is an operative
fact and may have consequences which cannot justly be ignored. The past cannot
always be erased by a new judicial declaration. The effect of the subsequent ruling as
to invalidity may have to be considered in various aspects,—with respect to particular
relations, individual and corporate, and particular conduct, private and official. Ques­
tions of rights claimed to become vested, of status, of prior determinations deemed
to have finality and acted upon accordingly, of public policy in the light of the nature
both of the statute and of its previous application, demand examination. These ques­
tions are among the most difficult of those which have engaged the attention of courts,
state and federal, and it is manifest from numerous decisions that an all-inclusive state­
ment of a principle of absolute retroactive invalidity cannot be justified." (Italics sup­plied).
agreement to renegotiate the contract price was not made by the con-
tractor voluntarily. Ordinarily no such possibility would appear, for
almost without exception the contractor does not protest to the inclusion
of the renegotiation clause in Government supply contracts at the
direction of the statute. But suppose that he does protest. Assume that
he states that he does not believe that the contract should contain the
renegotiation clause, but nevertheless signs the contract. Can it be
claimed under these circumstances that there is any coercion? It would
seem that there is none, even though there is a possibility that if the
contractor refuses to accept a supply contract which includes the renego-
tiation clause, the Government can take over his plant through the
exercise of its war powers as invoked by Congress in the Selective Train-

581 (1941). The counsel for the Government argued in this case that the Bethlehem
Steel Corporation had forced the contracting officers of the United States to sign con-
tracts with the corporation under duress and coercion. Commenting upon this conten-
tion, Mr. Justice Black, speaking for the Court, said at pp. 300 and 303-304:

"Duress. The word duress implies feebleness on one side, overpowering strength
on the other. Here it is suggested that feebleness is on the side of the Government of
the United States, overpowering strength on the side of a single private corporation.
Although there are many cases in which an individual has claimed to be a victim of
duress in dealings with government, e.g., Union Pacific R. Co. v. Public Service
Comm'n, 248 U.S. 67, this, so far as we know, is the first instance in which govern-
ment has claimed to be a victim of duress in dealings with an individual. . . .

"... We must therefore conclude that the negotiations do not show that Bethlehem
forced the Government's representatives to accept contracts against their will.

"If the negotiations do not establish duress, the Government finds it in the cir-
cumstances themselves. The petitioner concedes that the Government could have
commandeered Bethlehem's plants, but it contends that, if the plants had been com-
mandeered, Bethlehem's organization would have been unwilling to serve the Govern-
ment in them. Heavy reliance is placed on an observation in the Master's report that
'the Government did not have power to compel performance by an unwilling organi-
zation.' We shall later consider the alleged lack of power. We now point out that
the alleged unwillingness is an assumption unsupported by findings or evidence. Since
the possibility of commandeering appears not even to have been suggested to Bethlehem,
we have no basis for knowing what its reaction would have been. We cannot assume
that, if the negotiations failed to produce contracts acceptable to both sides, Bethlehem
would have refused to contribute to the war effort except under legal compulsion. We
cannot lightly impute to Bethlehem's whole organization, composed as it was of hun-
dreds of people, such an attitude of unpatriotic recalcitrance in the face of national peril.

"But even if we were to assume, as we do not, an initial attitude of unwillingness,
we do not think that the Government was entirely without means of overcoming it.
For, the representatives of the Fleet Corporation, an agent of the United States, came
to Bethlehem armed with bargaining powers to which those of no ordinary private
corporation can be compared. If it chose to, the Fleet Corporation could have foregone
all negotiation over price, compelling Bethlehem to undertake the work at a price set
by the President, with the burden of going to court if it considered the compensation
unreasonably low. And the power to commandeer Bethlehem's entire plant and facili-
The contractor may rely upon his constitutional rights surrounding the power of eminent domain; that is, the exercise of the power must be compensated for by the payment of the fair and reasonable value of the thing preempted by the Government. This alternative, however, gives the contractor no profit. Being too speculative, profits from a business cannot be included in damages allowed under condemnation proceedings. Accepting the clause, on the other hand, offers him an opportunity to make a profit within reasonable limits if he can; thus, he is given a benefit. If he clutches at the benefit,

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48 The United States Supreme Court summarized very well the elements included in just compensation in the case of Olson v. United States, 292 U.S. 246, 54 S. Ct. 704 (1934). On pp. 255 and 256 there appears the following statement by the Court:

"Just compensation includes all elements of value that inhere in the property, but it does not exceed market value fairly determined. The sum required to be paid the owner does not depend upon the uses to which he has devoted his land but is to be arrived at upon just consideration of all the uses for which it is suitable. The highest and most profitable use for which the property is adaptable and needed or likely to be needed in the reasonably near future is to be considered, not necessarily as the measure of value, but to the full extent that the prospect of demand for such use affects the market value while the property is privately held. Boom Co. v. Patterson, 98 U.S. 403, 408. Clark’s Ferry Bridge Co. v. Public Service Commission, 291 U.S. 227. Lewis, Eminent Domain, 3d ed., § 707, p. 1233. Nichols, Eminent Domain, 2d ed., § 220, p. 671. The fact that the most profitable use of a parcel can be made only in combination with other lands does not necessarily exclude that use from consideration if the possibility of combination is reasonably sufficient to affect market value. Nor does the fact that it may be or is being acquired by eminent domain negative consideration of availability for use in the public service. New York v. Sage, 239 U.S. 57, 61. It is common knowledge that public service corporations and others having that power frequently are actual or potential competitors, not only for tracts held in single ownership but also for rights of way, locations, sites and other areas requiring the union of numerous parcels held by different owners. And, to the extent that probable demand by prospective purchasers or condemns affects market value, it is to be taken into account. Boom Co. v. Patterson, ubi supra. But the value to be ascertained does not include, and the owner is not entitled to compensation for any element resulting subsequently to or because of the taking. Considerations that may not reasonably be held to affect market values are excluded. Value to the taker of a piece of land combined with other parcels for public use is not the measure of or a guide to the compensation to which the owner is entitled. New York v. Sage, ubi supra. United States v. Chandler-Dunbar Co., 229 U.S. 53, 76, 80..." (Italics the Court’s).

The holding in the case was that as just compensation included no increment resulting from the taking, plaintiffs were not entitled to elements of value arising from the prospect that the Government would acquire flowage easements.
he will be estopped from asserting that the statute is unconstitutional.\textsuperscript{49}
The contractor thus has a choice and there is no coercion to corrupt the public policy against excessive profits from war.

\textit{Delegation of Authority—The Act is Not Without a Standard}. The legislative function consists of the power to make policy and the power to make detail. The latter power is delegable.\textsuperscript{50} The Renegotiation Act is not unconstitutional on the ground that it provides a delegation of authority to the executive branch of the Government without a sufficient standard or guide. Congress has clearly declared its policy in the statute. It has stated that prices and profits in war contracts shall not be excessive and that when they become excessive in the opinion of the secretary of a given department, the secretary may eliminate them through means specified in the act.\textsuperscript{51}

The standard by which profits are to be judged is unquestionably broad. It is a standard of reasonableness, but even without additional guides to determine when profits “may be excessive,” this fact would not seem to be fatal. The determination of the policy is not left to an administrative body, as was true in the case of \textit{Schecter Poultry Corp. v. United States}\textsuperscript{52} and \textit{Panama Refining v. Ryan}.\textsuperscript{53} There is no abdication of the policy-making function of the legislature here. Nor is the situation like that in \textit{United States v. Cohen Grocery Company},\textsuperscript{54} where the Supreme Court held the Food Control Act\textsuperscript{55} of World War I unconstitutionally applied. In that case the statute imposed a penalty of fine or imprisonment or both for “any unjust or unreasonable rate or charge


\textsuperscript{50} See the forward looking opinion of Judge Rosenberry in State ex rel. Wisconsin Bureau v. Whitman, 196 Wis. 472, 220 N.W. 929 (1928).

\textsuperscript{51} Subsection (c) (1) of § 403 as amended, 56 Stat. L. 798 at 983, provides:

“Whenever, in the opinion of the Secretary of a Department, the profits realized or likely to be realized from any contract with such Department, or from any subcontract thereunder whether or not made by the contractor, may be excessive, the Secretary is authorized and directed to require the contractor or subcontractor to renegotiate the contract price. When the contractor or subcontractor holds two or more contracts or subcontracts, the Secretary in his discretion, may negotiate to eliminate excessive profits on some or all of such contracts and subcontracts as a group without separately renegotiating the contract price of each contract or subcontract.”

\textsuperscript{52} 295 U.S. 495, 55 S. Ct. 837 (1935).

\textsuperscript{53} 293 U. S. 388, 55 S. Ct. 241 (1935).

\textsuperscript{54} 255 U.S. 81, 41 S. Ct. 298 (1921).

in handling or dealing in or with any necessaries.\textsuperscript{7} The statute provided there a criminal penalty which the Court decided to be unconstitutional, because it lacked a definite standard having to do with the definition of a statutory crime. The statute did not concern itself with the standard by which an administrative officer is to act in relation to the determination of profits and the procurement of war supplies at fair prices.\textsuperscript{56}

The chain of cases beginning with \textit{Brig Aurora v. United States},\textsuperscript{57} has upheld many broad authorizations for administrative application of a policy established by Congress where Congress has enunciated an intelligible principle. Certainly the principle set forth in the Renegotiation Act is understandable and clear. The statute does not leave to the secretaries the power to legislate, but only the power to establish rules and procedure for carrying out the express will of Congress. There is not conferred upon administrative officers the power to make a law. The act is merely a grant of authority or discretion as to its execution, which must be exercised pursuant to the law through the application of the standards therein to varying factual situations.

It is quite plain that Congress itself could not review the thousands of war contracts to determine whether the profits were excessive and has in that light delegated this task to the executive branch of the Government. Here the rule of "what is reasonably necessary in view of what the times demand and of the end to be accomplished" obtains.\textsuperscript{58}

Moreover the statute prescribed certain standards and statutory guides to be considered by administrators in determining what profits are excessive. Section 403 (c) (3) provides:

\begin{quote}
"In determining the excessiveness of profits realized or likely to be realized from any contract or subcontract, the Secretary shall recognize the properly applicable exclusions and deductions of the
\end{quote}

\textsuperscript{56} United States v. Grimaud, 220 U.S. 506, 31 S. Ct. 480 (1911) upheld a statute which permitted the Department of Agriculture to determine the conditions which operated to cause depredations of national forestry resources and subjected violators to punishment.

\textsuperscript{57} 7 Cranch (II U.S.) 382 (1813); Field v. Clark, 143 U.S. 649, 12 S. Ct. 495 (1892).

character which the contractor or subcontractor is allowed under Chapter 1 and Chapter 2E of the Internal Revenue Code. In determining the amount of any excessive profits to be eliminated hereunder the Secretary shall allow the contractor or subcontractor credit for Federal income and excess profits taxes as provided in section 3806 of the Internal Revenue Code."

Section 403 (d) states:

"In renegotiating a contract price or determining excessive profits for the purpose of this section, the Secretaries of the respective Departments shall not make any allowance for any salaries, bonuses, or other compensation paid by a contractor to its officers or employees in excess of a reasonable amount, nor shall they make allowance for any excessive reserves set up by the contractor or for any cost incurred by the contractor which are excessive and unreasonable. For the purpose of ascertaining whether such unreasonable compensation has been or is being paid, or whether such excessive reserves have been or are being set up, or whether any excessive and unreasonable costs have been or are being incurred, each such Secretary shall have the same powers with respect to any such contractor that an agency designated by the President to exercise the powers conferred by Title XIII of the Second War Powers Act, 1942, has with respect to any contractor to whom such title is applicable. In the interest of economy and the avoidance of duplication of inspection and audit, the services of the Bureau of Internal Revenue shall, upon request of each such Secretary and the approval of the Secretary of the Treasury, be made available to the extent determined by the Secretary of the Treasury for the purposes of making examinations and determinations with respect to profits under this section."

It would not be practicable for Congress to outline in definite detail the methods for applying the principle of renegotiation. The statute contemplates that its administration will be a part of the procurement function of the departments procuring war implements. This fact is apparent from the act's being limited to so-called war contracts. It would be just as impracticable to set forth detailed standards with regard to this pricing function as it would to prescribe how fair

59 The Renegotiation Act includes only contracts and subcontracts made by or for the War, Navy and Treasury Departments, the Maritime Commission and the R.F.C. Subsidiaries, engaged in war procurement,—Defense Plant Corporation, Metals Reserve Company, Defense Supplies Corporation, and Rubber Reserve Company. The Treasury Department is included primarily because of its lend-lease activities. The War Shipping Administration is also conducting renegotiation through powers which it derives from the act and the Executive Order which established it as an agency separate and apart from the Maritime Commission as discussed in footnote 15, supra.
prices are to be determined by the departments in making their contracts.

Abuse of Administrative Discretion. To say that there is small likelihood of the act's being unconstitutional is not to say that the contractor is without recourse against and protection from abusive and capricious actions of administrative officers. Confiscation is not a legal vogue. The act permits a unilateral determination of excessive profits by the secretary of the agency conducting the renegotiation. As the act is presently administered, any ground for either injunction or damages is extremely remote. Nevertheless, should a finding of excessive profits be made under renegotiation which would be so outrageous as to constitute an abuse of discretion, a suit in equity would probably lie to restrain the official from enforcing his finding. Although this point is distinguishable from the constitutional issue, the question of constitutionality might be collaterally considered in such circumstances.

If an official acts without appropriate authority, an action at law for

60 The issue may be raised as to the act's unconstitutionality for failure to provide recourse to the courts. Upon careful analysis the act does not seem to be unconstitutional on this ground. There is no specific mention of judicial review of an administrative determination by one of the secretaries. It is believed that the silence of the law in this regard does not impair its constitutional character. In the field of public utility rate regulation, the courts have split as to the nature of the rate-making function. Some say the function is legislative; others say it is judicial. It is doubtful if the courts would reach any substantial disagreement in the case of determining excessive profits in as much as such a determination would appear clearly to be judicial in nature when measured by the usual standard of the administrative procedures used in reaching the desired result.

The law has not forbidden judicial review and in view of this fact, it would seem that recourse to the courts is readily available. It has been held available for the review of major and long-established activities of Government for which no remedy is provided by statute; (Postal Fraud Order, Alien Deportation, Determination by the Land Office of the extent of a land grant, etc.). Recourse to the courts has also been held available where the remedy provided by statute is not an adequate substitute or does not include the particular situation involved. The court would have to consider, of course, whether granting judicial review would interfere with the proper administration of the act. This is a matter of judicial self-limitation. A recent example is Perkins v. Lukens Steel Co., 310 U.S. 113, 60 S. Ct. 869 (1940), which denied the plaintiff a judicial review of wages determinations under the Walsh-Healey Act. The Walsh-Healey Act itself does not in terms either grant or deny judicial review of these determinations. No constitutional obstacle to review of the issues was present in the case, but the Court decided that the denial of a review in such instance was appropriately implied by legislative silence on the ground that the Government is free to contract with whom it pleases and was free to do so before the act was passed. The Court further concluded that the opportunity for judicial review would unduly interfere with the execution of Government contracts.

61 Subsection (a) (3) of § 403, 56 Stat. L. 797 at 982, provides:
"The terms 'renegotiate' and 'renegotiation' include the refixing by the Secretary of the Department of the contract price."
damages would be available to the contractor. In such a case it would be necessary to show that the administrative determination of excessive profits departed from the paths of authority which the statute provided, and became then a wrong to the contractor as an action by an official without the support of law. 62

Under present circumstances except with regard to those contracts in effect prior to the passage of the act there would be considerable difficulty in raising the question of the act's unconstitutionality in the courts. In the first place, as already pointed out, the contracts between the Government and most prime and subcontractors, contain renegotiation clauses by which the contracting parties are bound to renegotiate the price of the contract. Having once agreed, it would appear upon proper analysis, that any constitutional issue disappears. Moreover, if the contracts do not contain a renegotiation clause the doctrine of adoption of an applicable existing statute into a contract would operate to make the act part of the contract and the parties are equally bound and the effect is the same as though a renegotiation clause were stated in the contract. Excessive profits are generally eliminated by agreement, a point which has been made before, but where it is not possible for the Government and the contractor to agree upon an amount to be returned, recapture of the amount determined will proceed upon the basis of a unilateral determination by the Secretary of the Department which conducted the renegotiation. It is conceivable, of course, that if a settlement should be proposed by the Government to the contractor which is unfair, a case of abuse of discretion could be made and while an attack upon the statute for any alleged unconstitutionality would seem to have little chance of success, it is none the less true that the result in a given individual case might be upset for reasons of abuse of administrative discretion.

Determination of Excessive Profits—Administrative Standards and Procedure. Under the authority delegated to the designated agencies of the Government, these departments have formulated certain standards for the administration of this law. 63 Basic to the whole administra-


63 The War, Navy and Treasury Departments and the Maritime Commission joined to embody these standards which they had formulated in a joint statement. Joint Statement by the War, Navy and Treasury Departments and the Maritime Commission, for Purposes, Principles, Policies and Interpretations under § 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, Pub. L. 528, 77th Cong., 2d sess., approved April 28, 1942, as amended. This was published as of March 31, 1942 by the United States Government Printing Office. It described the purposes of
Renegotiation of War Contracts

The act is the fact that the circumstances of each individual producer are considered separately. There is no formula which is applied to every contractor. Instead each contractor's profits are measured for excessiveness with reference to the particular circumstances under which that contractor is producing.

In general the factors considered in determining the fairness of contractors' profits fall into three groups: (1) efficiency with which the contractor has performed his war contracts, (2) the risk which he has undertaken in that performance, and (3) his peacetime earnings during a "base period." The contractor's productive operations are compared with those of other contractors in ascertaining the margin of profit to which the contractor is entitled, and consideration is given to these factors of efficiency:

(a) Price reduction and comparative prices.
(b) Efficiency in reducing costs.
(c) Economy in the use of raw materials.
(d) Efficiency in the use of facilities and in the conservation of manpower.
(e) Character and extent of subcontracting.
(f) Quality of production.
(g) Complexity of manufacturing technique.
(h) Rate of delivery and turnover.
(i) Inventive and developmental contribution with respect to important war products.
(j) Cooperation with the Government and with other contractors in developing and supplying technical assistance to alternative or competitive sources of supply and the effect thereof on the contractor's future peacetime business.

Applicable items of risk include such matters as the complexity of the manufacturing technique with which the producer is confronted; the source of operating capital—whether supplied by the Government or the contractor; the rate of turnover and delivery; increases in the cost of materials and wages; special charges such as cancellation charges which have made the accomplishment of the contractor's operations more difficult and expensive; delays in production because of difficulty in obtaining raw materials. Certainly these considerations appear to be entirely reasonable, and, in relation to the question of abuse of adminis-

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64 Joint Statement, p. 7.
trenerative discretion, administration which adheres to these would probably give no ground for legal complaint.

Exemptions

Contracts and Sales Subject to the Statute. The Renegotiation Act is applicable to all sales made either directly through prime contracts or indirectly through subcontracts to the War, Navy, Treasury Departments, Maritime Commission, Defense Plant Corporation, Metals Reserve Company, Defense Supplies Corporation, and Rubber Reserve Company, upon which final payment was made after April 28, 1942, the effective date of the statute. Similarly such sales made either directly or indirectly to the War Shipping Administration are subject to renegotiation. These sales are ordinarily called "renegotiable"; all others are termed "non-renegotiable."

The term "subcontract" is defined as "any purchase order or agreement to perform all or any part of the work, or to make or furnish any article, required for the performance of another contract or subcontract." This definition does not recognize the distinction frequently made in business between a contractor and what is known as a "supplier" or "material man." It makes the law applicable to all agreements for the furnishing of services, articles, or other personal property necessary for the completion of the contract regardless of how remote they may be from the prime contract itself.

The most recent amendment to the act brings within its purview brokers, manufacturers' agents and dealers whose sales find their way either into products being sold to the departments of the Government named in the act or to manufacturers whose operations require the use of these items in the production of items sold to the departments, irrespective of whether they perform services in relation to such sales or hold themselves ready to perform such services.

65 For a discussion of the War Shipping Administration's derivation of powers with regard to renegotiation see footnote 15, supra.
66 Subsection (a) (5) of § 403, as amended.
67 Contrast this definition of "subcontract" with a more restricted definition applied by the Board of Tax Appeals under the Vinson-Trammel Act in the recent case of Aluminum Company of America v. Commissioner of Internal Revenue, 47 B. T. A. 543 (1942).
68 Pub. L. 149, 78th Cong., 1st sess., approved July 14, 1943, amended subsec. (5) of § 403 (a) to read as follows:
"The term 'subcontract' means (i) any purchase order or agreement to perform all or any part of the work, or to make or furnish any article, required for the performance of any other contract or subcontract or (ii) any contract or arrangement (other than a contract or arrangement between two contracting parties, one of which parties
Cost-plus-a-fixed-fee contracts are subject to the statute. And no exemption is granted because of the fact that the particular items being sold are under maximum price restrictions. The framers of the statute do not appear to have thought that such maximum price restrictions could be regarded as assurances that prices might not include profits that were unreasonable in relation to efficiency and risk.

is found by the Secretary to be a bona fide executive officer, partner, or full-time employee of the other contracting party), (A) any amount payable under which is contingent upon the procurement of a contract or contracts with a Department or of a subcontract or subcontracts thereunder, or determined with reference to the amount of such a contract or subcontract or such contracts or subcontracts, or (B) under which any part of the services performed or to be performed consists of the soliciting, attempting to procure, or procuring a contract or contracts with a Department or a subcontract or subcontracts thereunder: Provided, That nothing in this sentence shall be construed (1) to affect in any way the validity or construction of provisions in any contract with a Department or any subcontract thereunder, heretofore at any time or hereafter made, prohibiting the payment of contingent fees or commissions; or (2) to restrict in any way the authority of the Secretary to determine the nature or amount of selling expenses under subcontracts as defined in (ii) herein, as a proper element of the contract price or as a reimbursable item of cost, under a contract with a Department or a subcontract thereunder.”

Formerly this subsec. (5) of § 403(a), 56 Stat. L. 797 at 982, read as follows: “The term ‘subcontract’ means any purchase order or agreement to perform all or any part of the work, or to make or furnish any article, required for the performance of another contract or subcontract. The term ‘article’ includes any material, part, assembly, machinery, equipment, or other personal property.”

Under this original language it was determined that brokers, manufacturers’ agents and dealers were only subject to renegotiation when they perform services or hold themselves out as being ready to perform services in relation to the sales which they make. Such services are ordinarily of an engineering nature but frequently include help in obtaining materials, advice with regard to the arrangement of plants or other services relating to the manufacture or products relating to the departments. The amendment effected by Pub. L. 149, 78th Cong., 1st sess., approved July 14, 1943 and quoted above was designed to make the sales of individual and corporate brokers and dealers subject to renegotiation whether they rendered or either held themselves out ready to render services regardless of whether they rendered or represented themselves as being ready to render services of any nature.

To conform the act to this amendment, changes were necessary in other sections. The words “in each subcontract for an amount in excess of $100,000” appearing in subsec. (b) (3) of § 403 as amended, prior to Pub. L. 149, 78th Cong., 1st sess., were struck out and inserted in their place is this phrase: “In each subcontract described in subsection (a) (5) (ii) and in each subcontract for an amount in excess of $100,000 described in subsection (a) (5) (i).”

The first paragraph of subsec. (6) of § 403(c), 56 Stat. L. 797 at 984, of the act was also amended and reads: “(6) This subsection (c) shall be applicable to all contracts and subcontracts hereafter made and to all contracts and subcontracts heretofore made, whether or not such contracts or subcontracts contain a renegotiation or recapture clause, unless (i) final payment pursuant to such contract or subcontract was made prior to April 28, 1942, or (ii) the contract or subcontract provides otherwise pursuant to subsection (b)
Sales Exempted by the Statute. When the sales of a given contractor or subcontractor do not exceed $100,000 for the fiscal year under consideration, the contractor is granted an exemption by the statute.\(^68\) With regard to this exemption an interesting problem is raised in relation to the renegotiability of parent or affiliated companies. Subsection (c) (6) provides that in determining whether the aggregate sales of a contractor or subcontractor under contracts or subcontracts with the departments exceed $100,000, aggregate sales shall be considered as those made by the contractor or subcontractor "and by all persons under the control of or controlling or under common control with the contractor or subcontractor." Thus it will be seen in the case of a parent and subsidiary company where the parent has had $90,000 of renegotiable sales in the fiscal year being renegotiated and a subsidiary has had $500,000 of renegotiable sales in the same period, that the parent and subsidiary are subject to the statute, irrespective of whether they are considered on a consolidated basis or not. This would be so because the contractor and subcontractor are under common control.

Sales completely paid for before April 28, 1942 are not subject to the statute, but if final payment has not been received under a contract prior to that date, all the sales under that contract are subject to renegotiation.\(^69\)

\(^{68}\) Subsection (c) (6) of § 403 as amended.

\(^{69}\) Joint Statement, § J-PAB-2(a), amended. See footnote 28, supra.
Sales to other departments of the Federal Government, to local and municipal governments, to local political subdivisions, to state governments, and to foreign governments, are not renegotiable.\(^\text{10}\)

Contracts for certain materials are exempted from renegotiation by subsection (i) (1) (ii). There it is provided that the statute shall not be applicable to "any contract or subcontract for the products of a mine, oil well or gas well, or other mineral or natural deposit, or timber, which has not been processed, refined or treated beyond the first form or state suitable for industrial use," and the secretaries "are authorized by joint regulation to define, interpret and apply this exemption." By joint resolution under date of February 1, 1943, the term "exempted products" has been defined and all contracts or subcontracts with respect to these items are not renegotiable under the statute.\(^\text{11}\) If a contractor or subcontractor refines, processes, or treats an exempted product so as to change it from its exempted state to a non-exempted state, the exempted product is ordinarily treated as an item of cost at its established sale or market price for the purpose of renegotiation. Thus in the case of an integrated steel company the market price of the pig-iron, pig-iron being an exempted product, is ordinarily regarded as a cost in the renegotiation of the integrated company and as such is deducted in determining the profits arising from the company's sale of steel.

**Exemption by Administrative Order.** Subsection (i) (2) of the statute permits the secretary of the department concerned, within his discretion, to exempt certain contracts, or subcontracts from all or part of the provisions of the act. Contracts which might be subject to such discretionary exemption include contracts or subcontracts which are to be performed outside of the territorial limits of the continental United States or in Alaska.\(^\text{12}\)

The secretary may also exempt from the operation of the act for a given period or periods any contracts or subcontracts which he believes

\(^{10}\) Subsection (i) (1) (i) of § 403 as amended.

\(^{11}\) Exemptions listed in Joint Regulation interpreting and applying subsec. (i) (1) (ii) of § 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended by § 801 of the Revenue Act of 1942, dated February 1, 1943, War Department Procurement Regulations ¶ 1291. Pursuant to authority delegated to the Quartermaster General through subsec. (i) (2) (ii) of § 403 as amended and War Department Procurement Regulations, ¶ 1204-1208(2), the Quartermaster General has exempted certain contracts calling for the sale of fresh fruits, fresh vegetables, dairy products, poultry, meats, fish and sea foods, frozen vegetables, frozen fruits, bread and other bakery products, potato chips, compressed yeast, shell eggs and margarine. War Department Procurement Regulations, ¶ 1292.

\(^{12}\) Subsection (i) (2) (i) of § 403 as amended.
to be so drawn that profits can be determined with reasonable certainty. The secretary may also exempt contracts and subcontracts, the profits of which can be determined with reasonable certainty when the price is established, such as "certain classes of agreements for personal services, for the purchase of real property, perishable goods, or commodities the minimum price for the sale of which has been fixed by a public regulatory body, of leases and license agreements, and of agreements where the period of performance under such contract or subcontract will not be in excess of thirty days." Unless specifically exempted, however, all contracts which may be thus exempted, remain subject to the statute and are renegotiable.

**Exempted Subcontracts Under an Exempted Prime Contract.** When a prime contract is exempt from renegotiation the question occurs whether the subcontracts thereunder are likewise exempt. In the case of exemptions made mandatory by the statute subcontracts as well as prime contracts are exempted from its operation. Such exemptions apply to contracts made by a department having renegotiating authority with "any other department, bureau, agency or governmental corporation of the United States or with any Territory, possession, or State or

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73 Subsection (i) (2) (ii) of § 403 as amended.

74 This is the interpretation by the Joint Statement as set forth therein at § J-PAB-2(c), page 14. This certainly appears to be the correct analysis in as much as the specific action is required by the statute for these exemptions to be effective.

The authority to exempt from renegotiation contracts and subcontracts which are to be performed outside of the United States or in Alaska, has been delegated by the Secretary of War to the Chiefs of the Supply Services as well as the Material Command, Army Air Forces. The Secretary of the Navy has likewise delegated such an authority to the Undersecretary of the Navy. This authority is in relation to subsection (i) (ii) of the act. It is plain that this authority may be exercised with respect to existing contracts as well as to contracts that are to be executed and performed in the future. Similar authority has been delegated to the Director of Procurement by the Secretary of the Treasury.


Joint Statement, § J-PAB-2(b) (i) at p. 11 reads as follows:

"Subsection (i) (i) (i) of the statute provides that the statute shall not apply to any contract by a Department with any other department, bureau, agency or governmental corporation of the United States or with any Territory, possession, or State or any agency thereof or with any foreign government or any agency thereof. Contracts between such agencies or governmental corporations and private contractors, and subcontracts thereunder, are likewise not subject to renegotiation, except in those instances where the agency or governmental corporation is acting as a direct agent for a Department. In these instances, the contract is deemed to be with the principal for whom the agency or governmental corporation is acting as direct agent, and not with the agency or governmental corporation, and accordingly, if otherwise subject to renegotiation, will not be exempted."
any agency thereof or with any foreign government or any agency thereof. 76 And when an agreement is made for the products of mines, oil or gas wells and other mineral and natural deposits defined in the act, it makes no difference whether the agreement is by way of a prime or subcontract. 77 Moreover, when the prime contract itself is exempted by the statute that exemption acts as an umbrella for all subcontracts made under it and they are also exempted. Subcontracts made under prime contracts which are exempted by the discretionary acts of the secretaries are not, however, protected. From the standpoint of statutory construction this interpretation seems sound. Since the secretaries are specifically authorized to exempt both prime contracts and subcontracts, it would seem that exemptions granted by administrative order should apply only to the particular contracts to which they are given. If a prime contractor has less than $100,000 worth of sales and is exempted from renegotiation by subsection (e)(6), this exemption has no application to subcontractors furnishing articles under contracts with the prime contractor.

Real Estate Exemption. It will be noted that the term “article” in subsection (a)(5) includes “any material, part, assembly, machinery, equipment, or other personal property.” It was apparently the intention of Congress to exclude subcontracts for the sale of real estate, though not similar prime contracts. Originally there seemed to be some confusion as to the application of this exemption. It was apparently thought that the sale of an item by a subcontractor which was personalty at time of its sale, but later became affixed to realty, was not subject to renegotiation because in its final character the item sold was real estate. 78 Careful analysis, however, leads to the conclusion that renegotiation of the subcontract involved is not precluded by the affixation of the “article” to the real estate. 79 The wide variation in the law of

76 Subsection (i)(1)(i) of §403 as amended.
77 Subsection (i)(1)(ii) of §403 as amended.
79 The Joint Statement, § J-PAB-3 under date of March 31, 1943, has been amended as of July 10, 1943, and recognizes this analysis. This section of the Joint Statement now reads:

“Subcontracts for real property excluded.—The term ‘subcontract’ as used in Section 403 is defined to mean any purchase order or agreement to perform all or any part of the work, or to make or furnish any article, required for the performance of another contract or subcontract. The term ‘article’ is defined to mean any ‘material,’ by inference at least, thereby excluding real property sold as such. It follows, therefore, that an agreement for the sale of real property, even though ‘required for the performance of another contract or subcontract’ is not included in the definition of the term


fixtures in the forty-eight states is well-known. It is generally said that whether an article is intended to be a fixture or remain personalty depends upon the intention of the parties. Local taxing authorities, however, frequently consider such items as cranes and boilers to be realty for purposes of taxation even though these things are held to be personalty under the terms of chattel mortgages or conditional sales agreements for the purpose of enforcing the lien of the mortgagee or upholding title of the equitable or legal owner. It seems unlikely that Congress intended that the varying local laws should govern in deciding whether property is real or personal for purposes of renegotiation. The act is national in scope and it must surely be recognized that the success of its administration will, of necessity, require the ap-

'subcontract' as used in subsection (c) of the statute. Thus, if a contractor or subcontractor 'furnishes' land or buildings 'required for the performance of another contract or subcontracts' (i.e., for the performance of a renegotiable contract or subcontract), the contract or subcontract for the 'furnishing' of the land or buildings is not subject to renegotiation. This does not, however, exclude from renegotiation contracts or subcontracts for the sale, furnishing or installation of machinery, equipment, materials or other personal property made or furnished or installed for use in the processing of an end product or of an article incorporated in an end product even though such machinery, equipment, materials or other personal property may for other purposes be deemed to become real property by reason of its installation in a building or other affixation to the realty.

'The situation giving rise to this exemption of real property must be carefully distinguished from the case where the 'making or furnishing' of real property is the subject matter of a prime contract (or a subcontract thereunder) with one of the Departments or with a contractor acting as the agent or instrumentality for one of the Departments. Thus a contract with a Department or any agent or instrumentality thereof for the construction of a building, and all subcontracts thereunder, are subject to renegotiation, unless the subject matter of the contract is existing real property as distinguished from articles which become real property in the course of the performance of the contract or subcontract.

'It follows, therefore, that if the contract is for the construction of improvements on or to real property, and if the Government acting through a Department is to obtain title to such property either immediately or ultimately (i.e., contracts for plant and facilities), then such contract, including all subcontracts thereunder for the furnishing of services, or of articles such as building materials and structural steel which are personal property when furnished, but which became real property during the course of construction, are renegotiable, as well as subcontracts for the furnishing of all machinery and equipment installed in the building.

'If, however, a contract (other than a contract or subcontract to make or furnish machinery or equipment or other personal property, including articles to be affixed to the realty, to be used in the processing of an end product or of an article incorporated in an end product) is for the construction of real property for a contractor or subcontractor for the purpose of performing a renegotiable contract or subcontract, then such contracts and subcontracts thereunder are not subject to renegotiation even though improvements may be covered by Certificates of Necessity, so long as a Department is not either immediately or ultimately to acquire title thereto.'
plication of uniform criteria in determining whether contracts are re-
negotiable or exempt from its operation.

The standard which the departments have adopted makes reference
to the local law of fixtures where the property is located or transferred
unnecessary. Subcontracts for the sale of machinery, equipment or other
personal property are not excluded from renegotiation for the reason
that such items may be deemed to be real estate for other purposes
because of their affixation to the realty. If such articles are essentially
machinery or equipment in the commonly accepted sense, regardless of
the character of their annexation to the realty, or if they are clearly
other personal property at the time of the sale, the renegotiability of
subcontracts therefor will depend upon whether the item is used in
the processing of an end product or of an article incorporated in an end
product.

The problem of exempting contracts for the sale of real estate was
further clarified by an express exemption granted by the War and Navy
Departments for both prime and subcontracts which are for the pur-
chase or lease of any interest in real property, and the exemption
recognizes that the character of the article at the time of its sale deter-
mines whether it is to be exempted as being real property or whether
it falls outside of the exemption as being personalty for the purposes
of renegotiation. Therefore sales of articles which are real estate at the
time of their sale by the subcontractor must be distinguished from sales
of articles which are personalty at the time of their sale and later be-
come affixed to realty. The former are non-renegotiable and the latter
renegotiable. The departments have taken the position that if the
Government will ultimately acquire title to a building to be constructed
or to improvements upon real estate under a contract with one of the
departments having renegotiating authority that the prime contracts as
well as the subcontracts thereunder will be subject to renegotiation.
However, if it is not contemplated as part of the transaction that title
to the property will vest in the Government, the contracts and subcon-
tracts for the improvement to real estate or the construction of build-
ings on such property will not be subject to renegotiation even though
such work is done for the performance of contracts or subcontracts
which are in themselves renegotiable. The chief difficulty with this con-
cept arises in the cases where a prime contractor under a contract with
one of the departments has made subcontracts wherein there will be

80 This appears in a directive dated October 8, 1943 signed by the Under-
secretary of War.
furnished to him completed buildings or other improvements upon real property, title to which he will in turn pass to the Government.\textsuperscript{81} If the necessary conclusion from the departments' position is that these subcontracts are subject to renegotiation, apparently this is achieved by regarding the prime contractor as merely a conduit of title and thus considering the articles which had the character of personalty at the time they were sold under subcontracts as being then sold directly to the Government. In as much as many Government contracts have been made wherein the agreement is that the prime contractor will obtain title to the realty which he will later pass to the Government, this distinction is of some importance.

When facilities are to be acquired under the ordinary cost-plus-a-fixed-fee contract it is generally intended that the prime contractor shall act as a conduit of title and that title to equipment and facilities purchased under the contract will ultimately rest in the Government. The arrangement under the cost-plus-a-fixed-fee contract is such that the contractor frequently appears to be the Government's agent. Yet \textit{Alabama v. King \\& Boozer},\textsuperscript{82} and \textit{Curry v. United States},\textsuperscript{83} determined that cost-plus-a-fixed-fee contractors are not entitled to federal immunity from state taxation and are not agents of the Federal Government but independent contractors. These cases make it difficult, if not impossible, to regard the cost-plus-a-fixed-fee contractor as an agent of the Federal Government and sales to such a contractor as sales to the Federal Government. Hence sales of real estate by a subcontractor to a cost-plus-a-fixed-fee prime contractor are probably not renegotiable even though the nature of the prime contract indicates that title to the realty will ultimately rest in the Government.

\textit{Problems and Methods of Segregation of Sales and Allocation of Costs.} In furnishing the information upon which renegotiation is to be conducted the contractor is expected to segregate those sales which are renegotiable, that is, those that have been made directly or indirectly to the departments named, and those which are non-renegotiable. In many instances it is difficult, if not impossible, for the contractor to

\textsuperscript{81} Note this language from Joint Statement, § J-PAB-3, amendment dated June 24, 1943. See note 79 supra: "The situation giving rise to this exemption of real property must be carefully distinguished from the case where the 'making or furnishing' of real property is the subject matter of a prime contract (or a subcontract thereunder) with one of the Departments or with a contractor acting as the agent or instrumentality for one of the Departments."

\textsuperscript{82} 314 U.S. 1, 62 S. Ct. 43 (1941).

\textsuperscript{83} 314 U.S. 14, 62 S. Ct. 48 (1941).
determine exactly the end use of the articles which he sells and so he must resort to some method calculated to give a reasonably accurate result, such as the sampling of a reasonable number of orders or spot checking sales. In as much as the figures furnished the Government are the representation of the contractor and must remain his representation, in order to avoid any possible liability that might arise from an intentional or unintentional misrepresentation, he should be careful to disclose the method relied upon in achieving the result. It should be made clear to the Government's representatives and made a part of the record that the figures representing the segregation of sales were compiled on the basis of the methods described. If the method employed is acceptable to the Government, then the renegotiation can proceed without any further delay.

ALLOWABLE COSTS, EXCLUSIONS AND DEDUCTIONS

Exclusions and Deductions. In general the administrators of the Renegotiation Act are following the principles of the Bureau of Internal Revenue with regard to allowing exclusions and deductions from the contractors' gross profits. Thus in cases where there is a doubt as to whether a deduction of an item or its exclusion from profit will be granted, contractors can usually be guided by the Bureau of Internal Revenue's treatment of their particular problems. The Price Adjustment Boards are not, however, bound to consider these matters in the same light as does the Treasury, except to the extent to which subsection (c) (3) of the statute is effective. Subsection (c) (3) provides that "the properly applicable exclusions and deductions of the character which the contractor or subcontractor is allowed under Chapters 1 and 2E of the Internal Revenue Code," shall be recognized. The phrases "properly applicable" and "of the character" must have been used.

84 Subsection (e) of § 403, as amended.

United States v. Decker, U.S. District Court of Maryland, July 24, 1943, C.C.H. War Law Service, ¶ 29, 021, involved a rehearing after a conviction under an indictment for violation of subsec. (e) of § 403 as amended, in the furnishing of "statements of actual costs of production" which were false and misleading. The defendants were officers of a corporation which was being renegotiated by the Navy Department. The Navy Department's auditor was referred to the contractor's accounts which the defendant officers knew contained statements and items not properly chargeable to renegotiable contracts. The defendants contended that their actions did not constitute the "furnishing of a statement" and that the officers of the corporation were not "persons" within the meaning of subsec. (e) of § 403 as amended. However, the evidence in this case indicated that one of the officers had a much greater degree of guilt than the other and with relation to the former a motion for retrial was granted, conviction of the other being upheld.
advisedly in order to give the administrators of the law authority and discretion in applying this portion of the act.

**Salaries, Bonuses and Commissions.** Salaries, bonuses, commissions or other compensation are items of cost and deductible from gross profits but not if they are in excess of a reasonable amount. In determining whether they are excessive, the salaries of the officers in the pre-war years, the volume and complexity of the undertaking during the year under consideration, and amounts being paid to officers in other companies of similar size and nature are considered.

**Reserves.** Reserves for the liquidation of post-war risk, reconversion and rehabilitation are not allowed. Reserves for bad debts and physical shrinkage of inventory are usually permitted in renegotiation if they are allowed by the Bureau of Internal Revenue for federal tax purposes, and if it has been the policy of the company to establish such reserves.

**Interest.** Where borrowed capital is being used for financing the production of renegotiable contracts and subcontracts the interest on such capital is deductible in renegotiation. The time when such capital is borrowed is immaterial. The Internal Revenue Code permits this deduction and therefore it must be recognized in renegotiation to the extent that such capital is applicable to the financing of renegotiable contracts or subcontracts.

**Allowances for Advertising.** With regard to allowances for advertising expenditures, the statement of the Commissioner of Internal Revenue made on September 29, 1942, has been adopted as the policy of the departments in renegotiation. Advertising designed to keep the company's name before the public is a deductible item and may be allocated as a cost to renegotiable business; but advertising designed to sell a specific commercial product must be allocated as a cost to commercial business. Amounts spent for advertising in past years are used

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85 Subsection (d) of § 403, as amended.
86 This policy was dictated by Donald M. Nelson, Chairman of the War Production Board, under date of March 6, 1942, by letter to Undersecretary of the War and Navy Departments. Joint Statement, § J-PAB-6, p. 20.
87 Internal Revenue Code § 23(b), U. S. C. (1940), tit. 26, § 23 (b).
88 Section J-PAB-5 (d), p. 18.
89 Wartime tax avoidance. Statement of the Secretary of the Treasury to Joint Committee on Internal Revenue Taxation, May 28, 1942, p. 7, states the Treasury's attitude on this matter. An excellent discussion of the Treasury Department's position with regard to the deduction of advertising expense is to be found in a release by the Association of National Advertisers, Inc., dated August 28, 1942. Excerpts of this release are in I C.C.H. STANDARD FED. TAX SERVICE, § 19.23(a)-1 (1943).
as a guide in determining how much ought to be spent in advertising during the war. And whether these expenditures have a reasonable relation to the size of the business and its production, is also considered in determining if allowance should be made for them.

**Amortization Deductions.** Section 124 of the Internal Revenue Code permits the amortization of war facilities under Certificates of Necessity over a sixty months' period. In view of the provision of the Renegotiation Act which requires the recognition of the "properly applicable exclusions and deductions of the character which the contractor or subcontractor is allowed under Chapters 1 and 2E of the Internal Revenue Code," it is perfectly clear that the amortization deductions permitted by section 124 for purposes of taxation are also deductible in renegotiation. Thus normal depreciation is considered as an item of cost and an amount representing the difference between the accelerated amortization and the normal depreciation for accounting purposes is a deduction.

In as much as section 124 provides for an acceleration of the amortization period in the event that the emergency is declared to be ended in a period of less than five years, the taxpayer is permitted further to accelerate the amortization deductions over the shorter period. For example, if termination of the emergency period were declared at the end of a three-year period instead of a five-year period as selected for the base in the statute, the taxpayer could then go back to the point when he commenced amortization deductions and take the deductions over the three-year period at thirty-three and one-third per cent per year instead of the twenty per cent yearly as would have been the case in the five-year period.

The acceleration of the amortization period is a matter of great concern to contractors who have invested large sums of money with the expectation of taking advantage of the amortization deductions under section 124. Such an acceleration is specifically permitted for purposes of taxation. But is it permitted for purposes of renegotiation where the contractor has entered into an agreement of settlement? Will such agreements be reopened so as to permit the contractor to have the advantage of the additional deductions which are permitted for tax purposes? The departments have decided that renegotiation agreements will not be reopened to give the contractor the advantage of the acceleration of the amortization period. Administratively the contrac-

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90 Subsection (c) (3) of § 403 as amended.
tor's ability to reopen the agreement embodying the renegotiation settlement depends upon there being included in the agreement a reservation permitting a reopening in the event of an acceleration of the amortization period. As will be seen later, the form of agreement prescribed by the departments does not provide for any such reopening; and in view of the policy expressed, it is unlikely that such a provision will be agreed to on the part of the Government. The phrases "properly applicable" and "of the character" would seem to place upon tenuous grounds any right of the contractor to a reopening based upon subsection (c) (3) even though it be assumed that this section has been adopted as a part of the agreement.

Inventory Write-off—Charges for Plant Rearrangement—Accelerated Depreciation and Deferred Maintenance. A contractor is not permitted to write off commercial inventory and charge the cost of this inventory to the renegotiable business. The cost of converting plants to war work however, is a deductible charge in so far as such rearrangement does not constitute a permanent addition to the plant. 91 The departments in this regard are following the policy of the Bureau of Internal Revenue.

Although each case presents its own problem of accelerated depreciation, acceleration will generally be permitted in renegotiation if the Treasury Department has also allowed this as an additional charge. However, the departments are not bound to accept the Treasury's opinion in this regard and, if it appears to the administrators that there is an actual exhaustion and depletion of facilities over and above the normal rate, an acceleration of depreciation may be permitted even without a Treasury decision on the question.

All maintenance expenditures made during the fiscal year to keep machinery operating are allowable as items of cost. These items normally are to be charged against the earnings of the fiscal year in which it was necessary to make the expenditure to keep the machine in operation. The problem of deferred maintenance arises because many companies carry as a part of the cost of production a fund established on the basis of production for the replacement of perishable tools and other related items. In as much as the expenditure of this sum which accrues as production proceeds, does not normally take place precisely within the company's fiscal year and is therefore carried over in part into the next fiscal year, it is usually allowed as an item of cost by the Treasury.

This procedure has also been adopted in renegotiation. Demands for greatly increased production in extended periods of operation have, however, caused some companies to set up large sums of money as a reserve for deferred maintenance. Circumstances which seem to demand the establishment of these larger reserves have been of a sufficient duration in many instances to permit the establishment of a policy in this regard predicated upon actual necessity and production experience. But the departments have not approved this type of reserve where the company's history has not indicated that such an accrual method has been normally followed, that is, in cases where the sum set up is arbitrary.

**War Losses as Deductible Items.** War losses have been suffered by many companies during the period subject to renegotiation. The problem has arisen as to whether they are allowable as charges against renegotiable business. In the light of subsection (c) (3) war losses, as provided in section 127 of the Internal Revenue Code, are allowable if the loss of such property bears a reasonable relation to the performance of the contract or subcontracts which are being renegotiated.

**Carry-Over and Operating Losses.** Sections 23(s) and 122 of the Internal Revenue Code permit a carry-over of a net operating loss for the first and second preceding taxable years. If any part of this loss is reasonably related to the contracts and subcontracts being renegotiated, the departments regard it as a properly applicable deduction in renegotiation. The part determined so to be applicable is charged against the renegotiable sales, and the balance is charged against the commercial or non-renegotiable business of the contractor.\(^92\)

Since section 122 of the Internal Revenue Code also permits the "carry-back" of net operating losses that occur in subsequent years because of tax adjustment for prior years, the problem once again arises as to the reopening of a final settlement agreement in order to permit the contractor to take advantage of this measure. The departments have assumed the same position on this matter as they have in regard to section 124 of the code. Renegotiation agreements will not be reopened to give any consideration to net losses which occur in periods following the renegotiation period, settlement for which has been embodied in the agreement.\(^93\)

**Consideration of Parent and Subsidiary on a Consolidated Basis.** Although section 141 of the Internal Revenue Code gives affiliated

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groups within the meaning of section 141(d) the right to file a consolidated tax return, it does not seem that any such permissive rights obtain with respect to renegotiation. The rights delineated in section 141 relate to the returns in the payment of the tax rather than to the matters of exclusions and deductions which subsection (c)(3) of the Renegotiation Act requires the departments to recognize in renegotiation. Nevertheless fairness to the contractor and a practical recognition of the fact that many affiliated groups are operated as though they were one organization with very little regard to technical corporate separation has resulted in the adoption of a policy which ordinarily permits affiliated groups to be considered upon a consolidated basis.  

For purposes of taxation it is especially important even where an affiliated group is being considered on a consolidated basis, that there be an allocation of the amount of excessive profits to be recovered from the income of each company in the group. For if there is merely a general imposition of liability for the return of excessive profits on the affiliated group and no separate liability is fixed, there is a possibility that the Treasury Department will not permit either the parent or the subsidiaries in the group deductions of excessive profits for federal income tax purposes. Thus the renegotiation agreement must set forth specifically the allocation of the excessive profits, as determined in renegotiation, between the parent and the subsidiaries of the affiliated group.

**TAX EFFECT OF RENEGOTIATION**

With regard to the effect of renegotiation on federal taxes the Internal Revenue Code differentiates between renegotiation prior to and after the filing of the taxpayer’s return.  

Renegotiation made before the filing of a tax return operates to reduce both the contractor’s sales and income, on the theory that the contractor sold goods at prices higher than should have been charged and that the difference between what he charged and what he should have charged is the amount which has been determined to be excessive. Hence, if a contractor’s net profit before renegotiation and before taxes is $10,000,000 and his sales are $100,000,000 and it is agreed that $2,
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000,000 shall be returned to the Government through renegotiation, then his sales become $98,000,000 and his profit before taxes is $8,000,000. Taxes will be paid upon the basis of $8,000,000.

If the tax return has been filed by the contractor prior to renegotiation, he must then apply to the local agents of the Bureau of Internal Revenue for a computation of the tax. The bureau computes the tax upon the return as filed and if a copy of the return is not available, the computation is made upon a certified copy of the return and is furnished under certification by the bureau to the renegotiating agency. The amount of the tax as computed by the bureau is then regarded as a credit against the amount to be paid on renegotiation. For illustration, if $2,000,000 is to be paid to the Government as excessive profits and the return has been filed on the basis of earnings in the amount of $10,000,000, the credit to be applied against the renegotiation settlement, assuming that the contractor is on an eighty per cent basis, would be the amount by which the federal income and excess profits taxes are decreased through the elimination of the excessive profits for that fiscal year. Thus, in the illustration at hand the credit against renegotiation would be $1,600,000, being the difference between the tax on $10,000,000 and on $8,000,000.

It should be remembered that if renegotiation is completed after the filing of the tax return, renegotiation has the effect of a redetermination of income and therefore the post-war refund provided for in section 780, the carry-over and carry-back provisions of section 122 of the Internal Revenue Code and all other matters relating to federal taxation are affected. The taxpayer's income is regarded as being redetermined to the extent of the refund determined in renegotiation. Section 780 of the Internal Revenue Code establishes the post-war refund of excess profits tax. In considering the computation of credit under section 3806, it must be remembered that the post-war refund will be reckoned by the Bureau of Internal Revenue on the basis of the contractor's redetermined income after renegotiation. Thus section 781(b) of the Internal Revenue Code operates to reduce the post-war

Section 781(b) of the Internal Revenue Code, U. S. C. (Supp. II, 1942), tit. 26, § 781(b), provides:

"Effect of Refunds.—If an overpayment of the tax imposed by this subchapter for any taxable year for which a credit is provided in section 780(a) is refunded or credited to the taxpayer under the internal revenue laws, the credit, if any, provided in such section then existing in favor of the taxpayer shall be reduced by an amount equal to 10 per centum of the excess of the tax imposed by this subchapter on the basis of which such tax (in respect of which the internal revenue refund or credit
refund to the extent that it is attributable to any tax refund or credit where a post-war refund would be payable. It seems quite clear that the credit under section 3806 constitutes a refund within the meaning of section 781(b). This is the policy that has been adopted by the Treasury Department. In the example above therefore, assuming that the corporate taxpayer had an excess profits tax credit of $2,000,000, it will be subject to an excess profits tax of $7,200,000 and the post-war refund would have been $720,000. This post-war refund, however, will be reduced to $540,000 on the basis of income as redetermined after renegotiation involving a recapture of $2,000,000.

Many taxpayers are making claims with reference to sections 122, 721 and 722 of the Internal Revenue Code and have filed their returns based upon the assumption that their claims with respect to these sections are valid and will be allowed. Other taxpayers have filed returns upon the basis that certain disputed items will be ultimately decided in favor of the taxpayer. As already pointed out the credit will be computed upon the return as it is filed. If it is later determined, however, that these claims or any of the disputed items in the return are either denied or decided unfavorably to the taxpayer or if any action taken by the Treasury has the ultimate effect of granting the taxpayer a credit less than that which is allowable, then the amount which is the difference between the credit allowed and that which is allowable will be treated by the Treasury Department as an overpayment for the taxable year concerned and will be refunded or credited to the taxpayer as provided in section 3806 (c) of the Internal Revenue Code.

If the contractor is doing business as an individual or partnership the Current Tax Payment Act of 1943 gives rise to difficult problems with regard to the application of section 3806. Under a ruling by the

was made) was previously computed and paid, over the tax imposed by this subchapter as determined in connection with the determination of the amount of the overpayment. In such a case, if such credit provided in section 780(a) is less than the amount by which it is required to be reduced, or if there is no such credit then existing in favor of the taxpayer, the excess of such amount over the amount of such credit, if any, shall be carried forward as a charge against the taxpayer to be applied in reduction of a subsequent credit under section 780(a); and if no such subsequent credit is made in favor of the taxpayer, the amount of such charge (without interest) shall be paid by the taxpayer to the United States or the amount of bonds previously issued to the taxpayer under section 780(b) shall be adjusted on account of such charge.

97 Id.
99 A partnership, of course, files only an information return and the Federal
Treasury Department 100 the substantial effect of section 3806 of the Internal Revenue Code in relation to the Current Tax Payment Act of 1943 as it is applied to individuals and partnerships, is to place such taxpayers in the same position whether they file their tax returns before or after renegotiation. In as much as the obligation to pay taxes as imposed by chapter 1 of the Internal Revenue Code upon 1942 income was discharged effective as of September 1, 1943 by virtue of sections 6a and 6b of the Current Tax Payment Act of 1943, the Treasury Department has held that no credit is available to individuals in relation to renegotiation conducted for the year 1942. 101 Even though the Treasury will permit no credit under section 3806 to be applied in the renegotiation of individuals for the taxable year 1942, in computing the tax imposed by chapter 1 of the Internal Revenue Code during the taxable year 1943 wherein taxes for the years 1942 and 1943 are to be compared as provided in the Current Tax Payment Act of 1943, such individuals are allowed to reduce the amount of the 1942 income to the extent that any profits therein are determined to be excessive as the result of renegotiation for that year. This is permitted on the condition that such excessive profits are paid by the taxpayer at the close of the taxable year which follows the taxable year of 1943. 102

Since the return of profits found to be excessive in renegotiation is not treated as a reduction in 1942 income for the purposes of determining a credit to be applied against the amount to be returned under renegotiation for that year, individuals and partnerships may find themselves in a difficult financial situation through having to pay taxes currently upon 1943 income as well as having to make payments with regard to renegotiation of the 1942 income. In recognition of this problem the renegotiating agencies are taking steps to permit an extension of the time within which individuals or partnerships may make refunds of profits found to be excessive under renegotiation for the year 1942. This move is designed to prevent serious impairment of the cash and working capital position of such persons. In working out this policy, attention will be paid to the time and amount of tax pay-

101 Id. at 7.
102 Ibid.
ments which would have been required on the excessive profits had they not been refunded.

Also of importance to the taxpayer-contractor is the treatment of repayments under renegotiation for purposes of state income taxes. Although many states fail to take any recognition of the Renegotiation Law either in their legislatures or through their departments of taxation, at least nineteen states have now taken action in this regard.\textsuperscript{108}

\textbf{The Renegotiation Agreement}

Once a determination of excessive profits is agreed upon by the Price Adjustment Board and a given contractor, the final step is the embodying of that settlement in a written agreement. This agreement is final and conclusive according to its terms and any contingent liability that obtained with regard to a contractor's company prior to it may be eliminated with regard to business covered by the agreement.\textsuperscript{104} If it is determined that a contractor has not realized excessive profits within the meaning of the statute, the departments may give the contractor a clearance for the period under renegotiation. This clearance may be embodied in a final agreement or a clearance notice.\textsuperscript{105}

\textbf{Consent of Assignee to the Renegotiation Agreement}

Renegotiation may require the amendment of existing contracts to give effect to the price reductions agreed upon between the Government and the contractor. The Assignment of Claims Act of 1940\textsuperscript{106}

\textsuperscript{108} As of June 15, 1943, action had been taken by the following states: Alabama, Arizona, California, Colorado, Delaware, Georgia, Kansas, Kentucky, Maryland, Massachusetts, Minnesota, Mississippi, Montana, North Dakota, South Carolina, Tennessee, Vermont, Virginia, West Virginia, Wisconsin and Connecticut. The Philadelphia Receiver of Taxes has also taken action. Reference is made to \textit{State Tax Review}, Vol. 3, (C.C.H.) for May 28, 1943, June 15, 1943, December 10, 1943, and December 22, 1943.

\textsuperscript{104} By virtue of subsec. (c) (4) of \S\ 403 the secretary of the department conducting the renegotiation may make such "final or other agreements with a contractor or subcontractor for the elimination of excessive profits and for the discharge of any liability for excessive profits under this section, as the Secretary deems desirable .... Any such agreement shall be final and conclusive according to its terms; and except upon a showing of fraud or malfeasance or a wilful misrepresentation of a material fact, (i) such agreement shall not be reopened as to the matters agreed upon, and shall not be modified by any officer, employee, or agent of the United States; and (ii) such agreement and any determination made in accordance therewith shall not be annulled, modified, set aside, or disregarded in any suit, action, or proceeding." This language was embodied in the act by amendment. Pub. L. 753, 77th Cong., 2d sess., approved October 21, 1942, 56 Stat. L. 798 at 984.

\textsuperscript{105} Subsection (c) (4) of \S\ 403 as amended.

permits the assignment of Government contracts to financing institutions. Where these contracts have been assigned, the question arises as to whether the assignee’s consent to such contractual changes is necessary for him to be bound thereby.

The Assignment of Claims Act of 1940 provides that “any contract entered into by the War Department or the Navy Department may provide that payments to an assignee of any claim arising under such contract shall not be subject to reduction or set-off, and if it is so provided in such contract, such payments shall not be subject to reduction or set-off for any indebtedness of the assignor to the United States arising independently of such contract.” The clause authorizing assignment of Government contracts which is usually included in such instruments states that payments thereunder shall not be subject to reduction or set-off for the assignor’s indebtedness to the United States which arises independently of the contract.

Where profits from an individual contract which has been assigned pursuant to the Assignment of Claims Act of 1940 are found to be excessive in renegotiation and recapture of those profits is to be achieved either wholly or in part through a reduction in the price of the items to be delivered under such a contract, it is not unlikely that this change in the contract would be binding upon the assignee without his consent. But where renegotiation is conducted on an overall basis so that the profits flowing from all of the contractor’s renegotiable contracts are considered as a group, reductions in the price of one or several of such contracts for the purpose of recapturing excessive profits may call for a return of profits under one contract that did not flow entirely therefrom. In such a case it may appear that the language of the Assignment of Claims Act of 1940 quoted above would prevent a reduction in the contract price from being binding upon the assignee without his consent except to the extent that such a reduction would be attributable to excessive profits arising out of the particular contract in question rather than from other contracts. This conclusion seems sound unless the Renegotiation Act which was passed after the Assignment of Claims Act of 1940 has repealed the latter by inference with respect to this particular point. Complicating this inquiry still further is the

107 As authorized by subsec. (c) (1) of § 403 as amended.
108 Subsection (c) (2) (i) of § 403, 56 Stat. L. 797 at 983, as amended gives the secretary authority to eliminate excessive profits “(i) by reductions in the contract price of the contract or subcontract, or by other revision in its terms.”
constitutional issue of whether the Renegotiation Act can be applied to effect price reductions in contracts assigned before its passage. Where third parties have acquired rights under congressional authority of the Assignment of Claims Act of 1940 prior to the enactment of the Renegotiation Statute a different result may be required from that reached where renegotiation is applied retroactively to contracts with the Government which are not assigned.

The solution to this problem of whether the assignee's consent to alterations caused by renegotiation in assigned contracts is required before he is bound thereby raises so many complex and conflicting issues that it merits a separate treatment apart from this article. Suffice it to say here that the answers to the questions that are raised concerning the application of the Renegotiation Act in effecting price reductions for the recapture of excessive profits in assigned contracts are so uncertain as to make it advisable to obtain the assignee's consent when amending assigned contracts. This course of procedure is indicated although the United States in particular cases may have rights under the contract to vary amounts payable without the consent of either the assignor or assignee. To the extent that the assignor's approval to the changes is required, like approval should be obtained from the assignee.

Methods of Recapture

Various methods may be utilized by the departments to eliminate excessive profits under contracts and subcontracts. The terms of the contract or contracts may be revised as to price or otherwise; there may be a withholding of any amounts due to the contractor or subcontractor; excessive profits under a subcontract may be eliminated or recaptured by directing the prime contractor to withhold for the Government amounts which he owes to the subcontractor under the subcontract; the contractor or subcontractor may repay in cash any amount of excessive profits determined by the department; and the departments may employ any combination of these methods that they deem desirable in administering the act. In as much as the settlement agreement in renegotiation may embody one or more of these methods, agreements usually call for a cash refund or a reduction in prices or some combination of the two. Ordinarily, if only a cash refund is involved, there is no adjustment in the contractor's prices for the elimination of the excessive profits determined, although he will, when necessary, be asked to reduce prices on future deliveries so as to prevent the realization of excessive profits in future years. On the other hand, if the contractor
reduces his contract prices on future deliveries under fixed price contracts, the reduction must be made so that excessive profits will be eliminated through the delivery of units at the reduced price by the end of the fiscal year involved. This situation normally arises only in those cases where renegotiation is undertaken on estimated figures before the close of the fiscal year under consideration. Since renegotiation is essentially a re-pricing function, the departments are placing great emphasis upon price reductions.

When subcontracts are involved in renegotiation prices may be reduced with the provision that the prime contractor pass on the equivalent benefit to the Government through a corresponding reduction in the prices of its prime contracts or through a direct cash refund to the Government. The act as originally drawn gave rise to the fear that a subcontractor even though he had made price reductions as agreed through renegotiation might still be liable for excessive profits if the Government, for some reason or other, had failed to receive the benefit of the reduction. An amendment to the act, however, makes it clear that a contractor or subcontractor is required to refund excessive profits only if they have been "actually paid to him." 110

To recover any excessive profits which have been determined the departments are authorized to bring action in the appropriate courts. 111 Sureties under any contract or subcontracts which are renegotiated are specifically relieved from any liability for the repayment of profits found to be excessive under the statute. 112 And an agreement on the contractors' part to reduce prices for future deliveries is normally becoming a part of the renegotiation settlement. The Undersecretary of War made a statement recently before the House Ways and Means Committee that producers whose prices contain substantially excessive profits are operating with much less risk than those whose prices are free from such excessive profits.

In the light of this statement, it seems probable that contractors who operate on a smaller margin of profit can expect a better treatment in renegotiation that those whose margins of profit are excessive. The

110 Subsection (c) (2) of § 403 as amended. See also, Patterson, Robert P., U.S. Congress, Hearings before Senate Subcommittee of Committee on Finance, 77th Cong., 2d sess., on § 403 of Pub. L. 528 (September 29, 1942) p. 3 at p. 10, and Marbury, William L., U. S. Congress, Hearings before Senate Committee on Finance, 77th Cong., 2d sess., on § 403 of Pub. L. 528. (Revised.) (September 22 and 23, 1942). Page 1.
111 Subsection (c) (2) of § 403 as amended.
112 Ibid.
Undersecretary also indicated that while the results of renegotiation with respect to 1942 business of any contractor do not establish precedent because of the many variances in operating conditions, none the less, the 1942 settlements for renegotiation give the contractor a guide which should aid him in the determination of his prices for the delivery of war goods in 1943.\footnote{118}

**Statute of Limitations and Filing of Statements**

The Renegotiation Act will continue in effect during the period of the present war and for three years after its termination.\footnote{114} The life of the statute, however, must be distinguished from limitations of time after which renegotiation regarding any particular contract may be commenced. Subsection (c) (6) provides that no renegotiation of a contract price shall be commenced more than one year after the close of the fiscal year within which completion or termination of the contract or subcontract, as determined by the secretary, occurs. This is, in effect, a statute of limitations.

This particular limitation provision raises the problem as to when renegotiation is “commenced” within the meaning of the subsection. Although there is no guide in the statute with regard to this question,

\footnote{118} Patterson, Robert P., in Hearings before House Ways and Means Committee, 78th Cong., 1st sess., on H.R. 2324, H.R. 2698, and H.R. 3015 (September 20, 1943), p. 807 at 812 said in part:

"In many cases, particularly in the case of subcontractors, where hundreds—or even thousands—of individual products are involved, it has not been possible for the Department to examine in detail and currently reprice all individual products with respect to the year 1943. However, the Government has advised the contractors that excessive profits must be eliminated by them through reductions in the prices which are being currently charged for their individual products. In order to be fair, and at the same time to make this policy practicably effective, the War Department has announced two correlative principles:

"First, war contractors who operate on a clearly excessive margin of profit and maintain price levels which result in the realization of a substantial amount of excessive profits in 1943 will be treated in renegotiation on a basis which corresponds to the relatively small degree of risk of loss which they have incurred. Those contractors who reduce their prices to a point where they are realizing only a reasonable profit will be treated with comparable liberality by reason of the additional risk which they have assumed as a result of operating on a narrower margin of profit.

"Although it is recognized that the results of renegotiation for 1942 business cannot be regarded as an established precedent for the results of 1943 operations, since there are necessarily many variances in the conditions and results of operations in individual cases as well as generally, nevertheless the results of 1942 renegotiations do afford to the contractor a general guide with respect to the establishment of 1943 price policies in accordance with the foregoing principles."

\footnote{114} Subsection (h) of § 403 as amended.
the only logical assumption is that renegotiation commences when the contractor is notified by the department to furnish certain information relative to the statute. If the analogy from the usual statute of limitations is applicable here, it would seem that any action designed to give notice for the purpose of saving rights would be adequate and that meetings with the contractor need not be undertaken to start the running of this statute of limitations.

The act makes provision not only for a limitation period with relation to individual contractors but also permits insulation from its effect by fiscal years.115 Thereby contractors and subcontractors may limit the time during which renegotiation of a given fiscal year or years may be commenced, and if renegotiation is not begun within this time, they are relieved from any requirement to renegotiate with reference to these years. Thus the contingent liability which arises from the law may be removed after the passage of a period of time. To set up this limitation contractors and subcontractors holding renegotiable contracts must file statements of actual cost and other financial statements for the relevant prior fiscal year or years with the secretary of the department concerned.116 The secretary then has one year within which to give the contractor or subcontractor written notice that in his opinion the profit to be realized from all or any of the contracts or subcontracts may be excessive. A date and place for the initial conference must be set and the conference must be held within sixty days after notice is given. If notice is not given and renegotiation commenced117 within these periods or if notice is given and the renegotiation is not commenced within the sixty-day period, liability for renegotiation with regard to the fiscal year or years covered by the statements is discharged.

**LIABILITY OF DIRECTORS FOR SETTLEMENTS MADE PURSUANT TO RENEGOTIATION**

Much attention has been paid to the possible liability of directors for making an agreement of settlement pursuant to the Renegotiation Act. It is argued that if the officers and directors of a given company agree to the recapture of profits found to be excessive pursuant to the provisions of the act, they might be held liable in an action brought

115 Subsection (c) (5) of § 403 as amended.
116 Joint Regulation prescribing the form for Filing of Financial Data by contractors and subcontractors as provided by subsec. (c) (5) of § 403, etc., as amended by § 801 of the Revenue Act of 1942, dated February 1, 1943.
117 Note the distinction between notice and commencing renegotiation.
by the stockholders. It is difficult to understand the theory of this argument. Reliance for the success of any such action brought against the directors would have to rest upon some alleged impropriety on the part of the officers and directors in entering into the renegotiation agreement.

The courts, it is true, have come a long way from the case of *Spring's Appeal*,\(^{118}\) which relieved directors of liability for mistakes of judgment, no matter how gross, if they acted in good faith, and within the confines of their authority. Directors can no longer hide behind a claim of good faith in defense of their actions when they have not exercised reasonable skill and judgment, and the test would now seem to be not merely one of a director's good faith in taking action within the scope of his authority, but also whether he had under the circumstances, displayed a reasonable judgment.\(^{119}\) None the less it seems difficult to regard officers' and directors' accepting a renegotiation settlement which does not abuse the tenets of reason as either a breach of trust or lacking in exercise of reasonable judgment.\(^{120}\)

In considering whether or not directors have exercised reasonable judgment in the conduct of renegotiation and in agreeing to make a refund, important factors are the circumstances of war, the use of renegotiation as an instrument of national policy and procurement, and its acceptance by others in the business community.\(^{121}\) Also to be considered is the situation where a company refuses to sign renegotiation agreements. In this regard recognition would have to be given to the

\(^{118}\) 71 Pa. St. II (1872).

\(^{119}\) Hun v. Cary, 82 N.Y. 65 (1880).

\(^{120}\) For a discussion of the duty of corporate directors to exercise business judgment, see an article under this title by Rudolph E. Uhlman, 20 Bost. Univ. L. Rev. 488 (1940).

\(^{121}\) On June 30, 1943, Mr. Maurice Karker, Chairman, War Department Price Adjustment Board, in a statement on Renegotiation of War Contracts made in Hearings before the House Naval Affairs Committee, 78th Cong., 1st sess., pursuant to H. Res. 30, at p. 1004, reported the status of War Department Renegotiation as of May 29, 1943 to be as follows:

"Up to May 29, 1943, 12,622 contractors have been assigned for renegotiation including 9,842 to the War Department; 2,419 to the Navy Department; 67 to the Treasury Department; 289 to the Maritime Commission; and 5 to the War Shipping Administration. Of the 9,842 cases assigned to the War Department, written or oral agreements had been reached up to that time with 1,879 contractors, or 19.9%, 939 of which were covered by agreements executed for the Government and fully processed. At that time 4,207 contractors were engaged in renegotiation. Renegotiation had not as of that date begun in the remaining 3,756 of the cases assigned to the War Department."
fact that the control of procurement and the bulk of the nation’s business is in the hands of the departments having renegotiation authority.\textsuperscript{122}

What effect does the constitutionality or unconstitutionality of the act have upon any potential liability of officers and directors who agree to refund profits earned by a corporation? If the directors have conceded the unconstitutionality of the law or have been advised by counsel that the act is unconstitutional, it may well be that a return of profits to the Government under renegotiation is a breach of trust under the theory of \textit{Dodge v. Woolsey}.\textsuperscript{128} This case involved a suit in equity commenced by the stockholder of a bank against the tax collector of Ohio, a bank, and bank directors, to restrain them from the collection and payment of an Ohio tax on the ground that the tax was unconstitutional. The tax was admittedly unconstitutional because it infringed upon a previous statute of the legislature fixing the amount of tax that the bank should pay in lieu of all other taxes. The bank directors conceded to the stockholders the illegality of the tax but refused to resist payment because of the obstacles to contesting the tax in the state courts of Ohio. In granting the injunction sued for, the Court held that directors who fail to contest the validity of a statute which they have conceded to be unconstitutional are guilty of a breach of trust.

But if there is no concession of unconstitutionality certainly directors are under no obligation to contest the constitutionality of a statute requiring the corporation to pay out money. It is ordinarily a matter of internal discretion with the directors whether they will resist the payment of amounts claimed by a government or comply with such requests.\textsuperscript{124} The propriety of their decision rests once again upon

\textsuperscript{122} The \textit{Federal Reserve Bulletin} published by the Federal Reserve Board for April, 1943, at p. 288 reported that as of March, 1943, the physical volume of the nation was at least 65%.

\textsuperscript{128} 18 How. (59 U.S.) 331 (1855).

\textsuperscript{124} The case of United Cooper Securities Co. v. Amalgamated Cooper Co., 244 U.S. 261 at 263-264, 37 S. Ct. 509 (1917), contains this language:

"Whether or not a corporation shall seek to enforce in the courts a cause of action for damages, is, like other business questions, ordinarily a matter of internal management and is left to the discretion of directors, in the absence of instruction by vote of stockholders. Courts interfere seldom to control such discretion \textit{intra vires} the corporation, except where the directors are guilty of misconduct equivalent to a breach of trust..."

And the Court in \textit{Corbus v. Alaska Treadwell Gold Mining Co.}, 187 U.S.
whether the directors and officers have acted in good faith and with reasonable judgment.\footnote{125} And if they have, it would seem that they cannot be held liable for reasonable mistakes of a law.\footnote{126}

Another factor to be considered in determining whether directors are guilty of a breach of trust and can be held liable or enjoined in equity from the payment of a settlement agreed upon in renegotiation, is that the weight of public opinion against a corporation which resisted elimination of excessive profits during war might have a disastrous effect upon the company's future sales. If the directors, under the circumstances present at the time the corporation is asked to agree to return profits, would ordinarily, in the reasonable conduct of the corporation's business, seek the advice of counsel as to whether the corporation is legally required to make a refund under renegotiation if requested, or whether the act is unconstitutional, then such advice should be sought. But if the making of a refund under renegotiation be considered a matter involving business judgment rather than one of law then such advice of counsel would seem unnecessary.

The weight of the circumstances of the war, which require a profit limitation measure and the customary acceptance of the act by business generally, make it highly unlikely that any liability can be placed upon directors for making refunds or reducing prices pursuant to renegotiation agreements. No impropriety can be attached to actions in this regard if good faith and the dictates of reasonable care and judgment are followed and the usual methods prescribed by laws and regulations for the renegotiation procedure are adhered to.

**Remedies Where a Contractor Fails or Refuses to Renegotiate**

Unquestionably, the position of the contractor who refuses to enter into renegotiation agreements is of interest to many producers. The departments have taken the position that they desire to conclude re-

\footnote{125} 23 S. Ct. 157 (1903) determined that it was within the discretion of the Board of directors whether or not to contest certain license taxes.

\footnote{126} Certainly directors and officers are under no obligation, if they act in good faith, to contest the liability of a law which is later declared to be unconstitutional. And Day v. Codman, 39 N.J. Eq. 258 (1884), determined that a fiduciary should not be charged with the payment of municipal taxes, where the assessment was declared unconstitutional after the tax had been paid, when the payment was not only made in good faith, but upon the advice of counsel.

\footnote{128} Hodges v. New England Screw Company, 1 R.I. 312 (1850), affirmed on rehearing, 3 R.I. 9 (1853).
negotiation with the contractor on the basis of a mutual agreement, and they will exert every effort to reach such an agreement.\textsuperscript{127}

As a matter of practical policy, it is unlikely that many contractors while the war is continuing would decline to enter into a renegotiation settlement. The practical remedies available to the Government are powerful instruments of persuasion. Moreover, most contractors, regardless of the weapons in the hands of the Government to bring recalcitrant producers into the renegotiation fold, are earnestly and sincerely desirous of reaching a fair settlement.

But if a contractor did decide that he would not or could not agree to a proposed settlement, the Government would have available several remedies at law. The secretary is empowered to make a unilateral determination of excessive profits in the case of any contractor.\textsuperscript{128} After a finding by the secretary that the amount in question constituted excessive profits the Government could proceed to collect this amount in several different ways.\textsuperscript{129} If the producer had contracts with the Government containing amounts sufficient to liquidate the amount of ex-

\textsuperscript{127} Joint Statement, p. 5.

If however, the contractor refuses to agree to a finding made by the Price Adjustment Board and which has been considered by the board to be reasonable, the Joint Statement issued by the department states:

"In the event it becomes impossible to reach a mutual agreement, the case is then referred to the official of the Department or the Commission to whom authority has been delegated under the statute, who gives consideration to the use of such special measures as he may deem necessary or advisable."

\textsuperscript{128} Subsection (a) (3) of § 403 as amended.

\textsuperscript{129} The procedures which the departments may follow in the instance of the unilateral determination of excessive profits and the collection thereunder are likely to be along the following lines:

1. The entry of a finding with regard to the fiscal year under renegotiation determining the amount of excessive profits.

2. The direction of withholding under the contractor's prime contracts with the Government as well as through other Government prime contractors whereunder the contractor is a subcontractor.

3. When necessary to insure reasonable future prices the conduct of an audit to determine the fairness of the contractor's current prices and the requirement that the contractor should make delivery of future goods which include only a fair margin of profit as determined by the secretary. If the company is not willing to accept orders at such prices then it is likely that mandatory orders will be placed requiring performance when other suppliers are not available. If there is further refusal to perform, of course, the contractor's plant can be taken over by the Government.

4. Renegotiation of the next period subject to renegotiation will be immediately instituted to the extent to which it has been completed and a unilateral determination of the excessiveness of profits in that period will be entered and collections made upon the basis of such a determination.
cessive profits, collection could be made through withholding such sums, either for goods delivered or to be delivered. This remedy would seem to be available both with regard to prime contractors and subcontractors. Recapture of excessive profits under these circumstances could also be made by an action in the federal courts. This remedy is specifically provided for in the statute.\footnote{Subsection (c) (2) of § 403 as amended.}

If the contractor chose to challenge the legality of the secretary's finding with regard to excessive profits, he could seek an injunction to restrain the secretary from enforcing his finding, as has been discussed before; or the contractor could permit an action to be brought against him in the federal courts for the recovery of the amount in question. And if the secretary undertook to collect the amount found to be excessive through withholding sums due to company under prime contracts with the Government or under subcontracts through other prime contractors, the company could bring an action for recovery of amounts so withheld. The defense of the Government in such an action would be the secretary's findings pursuant to the Renegotiation Act. This would probably be met by an argument on the part of the contractor that the law was unconstitutional or that the secretary's findings were so unreasonable as to constitute an abuse of discretion.

**Concluding Remarks**

If renegotiation is recognized for what it is—an instrument of war procurement, a kind of past pricing arrangement—the statute and administrative interpretations become more easily understood. The law was not conceived nor is it applied as a punitive measure. It was not conceived nor is it applied as a tax measure. In the enactment of renegotiation, Congress fully recognized that it is primarily a part of the procurement procedure. The view is taken that renegotiation is as essential to good purchasing in time of war as is free and open competition in time of peace.

As is true of most laws depending upon broad administrative action for the accomplishment of a given purpose, the act lodges great discretionary power in its administrators. This, of course, creates uncertainty and a contingent liability upon the earnings of business. The hardship suffered by business in this respect, however, appears to be offset by the flexibility of renegotiation which permits the application
of the statute to each producer individually. This flexibility would seem to guarantee advantages outweighing any such uncertainty.

There is only one phase of major importance that would cause renegotiation to fail. Because of the size of this undertaking, it is going to be difficult to cover all contractors subject to renegotiation within a reasonable time. Yet it is obviously essential to the success of the act that all contractors falling within its scope must be renegotiated within a reasonable time after the determination of their earnings. The contingent liability created by the statute must be removed within sufficient time to permit business to proceed with its plans of production under circumstances of the greatest certainty possible. The administrators of renegotiation are making real efforts to speed up the procedure to accomplish this purpose. These efforts appear likely to bear fruit.

Certain important changes in the law have been recently proposed. It has been urged that the determination of excessive profits be made after rather than before taxes; that reserves for post-war rehabilitation of plant and equipment be permitted, a change that will require an alteration in the tax laws so that such reserves may be free from taxation; that the present $100,000 exemption be changed to exclude from renegotiation those companies having less than $500,000 of otherwise renegotiable business. The renegotiation agencies have opposed the adoption of the first two suggestions but have favored the last one and it appears likely that the present exemption of $100,000 will be raised to $500,000 for the fiscal year ending after June 30, 1943.

There has been some agitation to re-define "subcontract" so as to include only subcontracts for the article, work, services, building, structure, improvement or facility contracted for under the prime contract or for articles to be incorporated in the item contracted for under the prime contract. The effect of such an alteration of the law would be to eliminate from renegotiation those persons who do not manufacture articles that become a part of or furnish services that directly relate to products finally sold to one of the departments having renegotiating authority. The elimination of standard commercial articles from renegotiation has been urged. Such changes are not regarded favorably by the departments.

A review of any determination of excessive profits by either the Court of Claims or the Tax Court for all determinations of excessive profits made by the secretaries is another suggested alteration in the statute. An amendment to the act which would permit post-war re-
habilitation to be considered as an item of cost has been proposed. It is essential, of course, that if such an amendment is to be made effective it would have to be through an alteration in the tax laws. And for that reason it seems fundamental that the place for such a change to be effected is in the tax statutes. Even though there have been sound arguments for the recognition and allowance of such reserves in renegotiation no substantial benefit could accrue to business unless the tax statutes were altered in this way.

Although some of these changes appear likely to be made in the act it is not probable that its fundamental concepts will be affected. It seems likely that renegotiation is going to be in operation as long as the war continues.†

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