

# THE AIR FORCE LAW REVIEW

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VOL. 53

2002

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# MILITARY HOUSING PRIVATIZATION INITIATIVE: A GUIDANCE DOCUMENT FOR WADING THROUGH THE LEGAL MORASS

CAPTAIN STACIE A. REMY VEST\*

“The air-conditioning and heating vents are completely clogged. The only air or heat [they] get is from a narrow opening in a window frame between the kitchen and the dining room. To keep cool during the summer, they sleep on a fold-out futon downstairs in the family room. [Trish] has given up trying to scrub away the mold in her bathrooms....In their kitchen, the doors to the cupboards have been painted over so many times they no longer shut. They’ve given up trying to open a patio door in the kitchen because it’s so clogged with paint.”<sup>1</sup>

## I. INTRODUCTION

### A. How to House the Families?

This news article describing the family housing conditions at Fort Meade, Maryland, typifies the problem with much of the military family housing across the Services. The problem is significant with nearly two-thirds of the Department of Defense’s (DoD) housing inventory needing repair or complete rehabilitation.<sup>2</sup> The severity of the problem motivated the DoD to seek new ways to remedy the problem of old and dilapidated housing. In 1996, Congress stepped in and enacted the Military Housing Privatization Initiative (MHPI) as part of the National Defense Authorization Act for Fiscal

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<sup>1</sup> Ellen Sorokin, At Home, A Losing Battle; Military Personnel Leaving Service Over Poor Housing, THE WASHINGTON TIMES, July 23, 2000, at C1.

<sup>2</sup> This represents approximately 200,000 housing units across all branches of the military. *Military Housing Privatization Initiative: Hearings Before the Subcomm. on Military Installations and Facilities of the House Comm. on National Security*, 102nd Cong. (1996) [hereinafter 1996 *Hearings*] (statement of Robert E. Bayer, Deputy Assistant Secretary of Defense, Installations), accessible through the Congressional Testimony 1997 page of the congressional testimony link at the Military Housing Privatization web site of the Office of the Deputy Under Secretary of Defense (Installations and Environment) (DUSD(I&E)), <http://www.defenselink.mil/acq/installation/hrso/>.

Year 1996.<sup>3</sup> The MHPI gave the DoD a number of special authorities aimed at eliminating its aging, dilapidated and unsafe family housing.<sup>4</sup>

The DoD claimed that the new housing privatization authorities would allow it to repair, replace and rehabilitate over 200,000 inadequate family housing units by fiscal year 2006, three to four times faster than with traditional methods.<sup>5</sup> In 1996, DoD projected it would award eight to ten MHPI projects for 2,000 housing units within a year of the authority being passed.<sup>6</sup>

Nearly six years after MHPI was passed, DoD has discovered that providing housing under MHPI is not as fast as it anticipated. As of March 2002, the military services have awarded only fourteen housing projects, with thirty more in various stages of solicitation.<sup>7</sup> The DoD claims implementation of the MHPI program has been slower than anticipated because it is a new way of doing business for the military and the private sector, with a significant learning curve.<sup>8</sup>

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<sup>3</sup> National Defense Authorization Act for Fiscal Year 1996, Pub. L. No. 104-106, § 2801(a)(1), 110 Stat. 186 (February 1996), amended chapter 169 of title 10, United States Code, to add a new subchapter entitled Alternative Authority To Construct and Improve Military Housing (codified as amended at 10 U.S.C.A. §§ 2871-2885 (West 2001)).

<sup>4</sup> *Id.*

<sup>5</sup> GENERAL ACCOUNTING OFFICE, MILITARY HOUSING: CONTINUED CONCERNS IN IMPLEMENTING THE PRIVATIZATION INITIATIVE, GAO/NSIAD-00-71 (Mar. 30, 2000), <http://www.gao.gov> (GAO Reports, Fiscal 2000, National Defense) [hereinafter 2000 GAO REPORT]. The DoD revised this estimate to fiscal year 2010. *Id.*

<sup>6</sup> 1996 *Hearings*, *supra* note 2 (statement of Robert E. Bayer, Deputy Assistant Secretary of Defense, Installations). The DoD also anticipated MHPI projects would cost the Government less than using traditional military construction funds for building and repairing housing units. *Id.* The DoD planned to leverage Government construction dollars, with a goal of spending no more than \$1 for every \$3 of private capital invested in MHPI projects. GENERAL ACCOUNTING OFFICE, MILITARY HOUSING: PRIVATIZATION OFF TO A SLOW START AND CONTINUED MANAGEMENT ATTENTION NEEDED, GAO/NSIAD-98-178 at ch. 1:2.1 (Jul. 17, 1998), <http://www.gao.gov>, link to GAO Archive at GPO (GAO Reports, Fiscal 1998, National Defense) [hereinafter 1998 GAO REPORT].

<sup>7</sup> Office Of The Under Secretary Of Defense For Acquisition, Technology And Logistics, Competitive Sourcing and Privatization Office, *Military Housing Privatization Web Site*, at <http://www.defenselink.mil/acq/installation/hrso/index.htm> (last visited Jun. 24, 2002). The projects awarded to date represent renovation or construction of 17,478 housing units. *Id.* The projects in solicitation consist of 47,802 housing units. *Id.* Across the Services, there are an additional thirty projects in the planning stages, consisting of an estimated 47,448 units. *Id.* Lackland AFB, Texas and Fort Carson, Colorado were the first two installations to award MHPI projects. *Id.* The Navy has projects near Naval installations in Texas and Washington. *Id.* Camp Pendleton, California, will be the first use of the MHPI authority by the Marines. *Military Housing Privatization Initiative: Hearings Before the Subcomm. on Military Installations and Facilities of the House Comm. on Armed Services*, 106th Cong. (2000) [hereinafter 2000 *Hearings*] (statement of Randall A. Yim, Deputy Under Secretary of Defense, Installations), <http://www.defenselink.mil/acq/installation/hrso/>.

<sup>8</sup> 2000 GAO REPORT, *supra* note 5.

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## B. Policy Promulgation is Needed

The MHPI has left a wake of new and unique issues in its path for policy makers, commanders, and Judge Advocates at all levels to resolve. These issues arise in both the contract formation and contract administration stages. Housing privatization impacts many facets of installation operations, and the resulting issues cross legal functional areas involving contract and fiscal law, installation control and criminal jurisdiction, ethics and environmental law. Only a few installations have MHPI projects in the occupancy phase, but based on their experience, MHPI changes the traditional way installations do business. There is little formal guidance from DoD or the Service Secretaries, so each installation is resolving issues that arise on an *ad hoc* basis. The Services and DoD have failed thus far to formally capture and disseminate the information or lessons learned from installations with privatized housing.<sup>9</sup> Consequently, installation attorneys across the Services, and even within Services at different installations, are “re-inventing the wheel” each time an issue arises. Complicating matters further, installations are using

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<sup>9</sup> In 2002, the Air Force Judge Advocate General School and Air Force Material Command jointly hosted a family housing privatization workshop. As of early 2002, the Army’s housing privatization web site contained links to current housing privatization solicitations, but provided little information or guidance for attorneys in the field regarding MHPI issues. See Office of the Assistant Secretary of the Army for Installations and the Environment, *The Army’s Residential Communities Initiative*, at <http://www.rci.army.mil>. The Army’s Office of General Counsel and Judge Advocate General web sites are similarly without guidance. See, e.g., Army Judge Advocate General’s Corp, at <http://www.jagcnet.army.mil/databases/>; General Counsel of the Army, at <http://www.hqda.army.mil/ogc>. The Navy’s housing privatization web site contains a few of the guidance documents developed by the Department of Defense relevant to MHPI projects concerning utilities and property taxes. See Public Private Ventures, *Navy & Marine Corp Housing*, at <http://ppv.hsgnavfac.com/policy/index.htm>. However, it contains little of direct relevance to an installation level attorney attempting to develop an MHPI agreement. *Id.* MHPI related information can be found at a number of Air Force organizational web sites, as there presently is not any central organization responsible for MHPI related information. See, e.g., Air Force Center of Environmental Excellence, *Housing Privatization*, at <http://www.afcee.brooks.af.mil/dc/dcp/news/>; Air Force Deputy Chief of Staff for Installations and Logistics, *Office of the Civil Engineer*, at <http://www.il.hq.af.mil/ile/>. The Air Force Judge Advocate General has designated the Air Force Material Command Law Office Real Estate Division (AFMC LO/JAVR) as the Office of Primary Responsibility for all legal matters in the area of housing privatization. TJAG Special Subject Letter 2001-09 (7 Dec. 2001). The JAVR website is the most detailed and potentially helpful Air Force web site. It provides a listing of the various statutes, regulations, and DoD memoranda related to MHPI projects. See Wright Patterson AFB, *Privatization Legal Issues*, at <https://www.afmc-mil.wpafb.af.mil/HQ-AFMC/JA/lo/lojav/privatization/housing/index3.htm>. It also contains a variety of informal point papers, background papers and memoranda addressing issues that may arise at the installation level. See *id.* However, these resources raise more questions than they answer and fail to provide specific guidance that would help the attorney in the field effectively analyze issues that arise on the installation.

different legal and contractual structures that may affect the resolution of any given issue.

This article will attempt to reduce the information void surrounding MHPI projects by exposing key legal issues and providing some guidance for those working MHPI issues in the field. First, the military family housing problem, the new legislation, and MHPI projects completed to date will be addressed to provide the backdrop for later discussion of MHPI legal issues.<sup>10</sup> Second, the article will identify issues arising out of the MHPI process at the contract formation stage. It will focus on legal issues regarding the applicability of traditional procurement policies, procedures and other laws, such as labor and contract laws, to MHPI projects.<sup>11</sup> Third, the article will examine issues arising during contract performance.<sup>12</sup> In the area of installation control, this paper will examine how MHPI affects the installation commander's ability to authorize searches and bar individuals from the installation.<sup>13</sup> Next is a discussion of the fiscal law questions installation attorneys are fielding regarding the use of appropriated funds on MHPI projects.<sup>14</sup> This article will then examine several ethics issues related to MHPI projects.<sup>15</sup> Finally, it will briefly address the applicability of the National Historical Preservation Act, an environmental issue that has impacted a MHPI project and has the potential to impact others.<sup>16</sup> Overall, this article exposes a lack of guidance for the field, demonstrating an obvious need for the Services to develop a formal program for gathering and disseminating information, providing guidance and setting policies.

## **II. BACKGROUND**

### **A. How We Have Housed Our Families -- Traditional Military Family Housing**

The DoD owns, operates, and maintains an inventory of over 300,000 family housing units.<sup>17</sup> Approximately one-third of all military families live in these Government-owned or Government-leased units.<sup>18</sup> Unfortunately, the

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<sup>10</sup> See *infra* Part II.

<sup>11</sup> See *infra* Part III.

<sup>12</sup> See *infra* Part IV.

<sup>13</sup> See *infra* Part IV.A.

<sup>14</sup> See *infra* Part IV.B.

<sup>15</sup> See *infra* Part IV.C.

<sup>16</sup> See *infra* Part IV.D.

<sup>17</sup> 1996 *Hearings*, *supra* note 2 (statement of Robert E. Bayer, Deputy Assistant Secretary of Defense, Installations). The Air Force alone operates and maintains approximately 110,000 housing units at military installations in the United States and overseas. Draft Air Force Housing Privatization Policy and Guidance Manual, section 2.1 (HQ USAF/ILEHM, 10 Oct. 2001)(on file with author).

<sup>18</sup> 1996 *Hearings*, *supra* note 2 (statement of Robert E. Bayer, Deputy Assistant Secretary of Defense, Installations).

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conditions at Fort Meade, Maryland, described in the opening quote are typical of DoD's aging family housing on military installations across the country. The problem is twofold: dilapidated housing on the installations and insufficient affordable housing for service members off the installation.<sup>19</sup> Nearly two-thirds of DoD housing units require renovation or replacement.<sup>20</sup> The DoD estimates it will cost approximately \$20 billion over thirty to forty years to complete the work using traditional military construction dollars.<sup>21</sup> The military Services recognize that the housing situation has a significant impact on the quality of life and retention of active-duty service members.<sup>22</sup>

Resolving this issue is more complex than simply moving service members off the installation into private sector housing.<sup>23</sup> Although all Services prefer to rely on the private sector for housing, many young airmen, soldiers, sailors and marines, cannot afford suitable private sector housing.<sup>24</sup> It

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<sup>19</sup> Office of the Under Secretary of Defense for Acquisition, Technology and Logistics, *The Privatization of Military Housing*, at <http://www.acq.osd.mil/installation/hrso/hrsohome.htm>. The Air Force indicated it would take 24 years at current funding levels to accomplish the major renovation and replacement required for 60,000 of their 114,000 family housing units. 1996 *Hearings*, *supra* note 2 (statement of Jimmy Dishner, Deputy Assistant Secretary of the Air Force). It now is estimated that approximately 59% of the Air Force military family housing does not meet standards and will require either major improvement or replacement. Draft Air Force Housing Privatization Policy and Guidance Manual, *supra* note 17. The Navy stated that housing allowances provided to members who live off the installation are grossly inadequate, leaving significant out-of-pocket expenses for military members. 1996 *Hearings*, *supra* note 2 (statement of Duncan A. Holaday, Deputy Assistant Secretary of the Navy, Installations and Facilities).

<sup>20</sup> This represents approximately 200,000 housing units across all branches of the military. 1996 *Hearings*, *supra* note 2 (statement of Robert E. Bayer, Deputy Assistant Secretary of Defense, Installations).

<sup>21</sup> *Id.* In addition, approximately 62% of 400,000 unaccompanied housing spaces require repair estimated at \$9 billion. Office of the Under Secretary of Defense for Acquisition, Technology and Logistics, *The Privatization of Military Housing*, at <http://www.acq.osd.mil/installation/hrso/about.htm>.

<sup>22</sup> *Military Housing Privatization Initiative: Hearings Before the Subcomm. on Military Installations and Facilities of the House Comm. on Armed Services*, 105th Cong. (1999) [hereinafter 1999 *Hearings*] (statement of Randall A. Yim, Acting Deputy Under Secretary of Defense, Installations), <http://www.acq.osd.mil/installation/hrso>.

<sup>23</sup> 1996 *Hearings*, *supra* note 2 (statement of Duncan A. Holaday, Assistant Secretary of the Navy, Installation and Facilities).

<sup>24</sup> Service members who choose to live off the installation, those who are not eligible for military housing and those who cannot get military housing due to unavailability receive a Basic Allowance for Housing (BAH) each month to pay for housing. GENERAL ACCOUNTING OFFICE, MILITARY FAMILY HOUSING: OPPORTUNITIES EXIST TO REDUCE COSTS AND MITIGATE INEQUITIES, GAO/NSIAD-96-203 at ch. 1:1 (Sept. 13, 1996). By law, BAH rates are based on the costs of adequate housing for civilians of comparable income in the same area, but cannot fall below rates based on the national average monthly housing costs. 37 U.S.C.A. § 403(b) (West 2001). Using these statutory factors, the DoD seeks to set BAH rates that cover 85% of a service member's housing costs, but they currently only cover 80.5%, leaving members to pay an average of 19.5% of their housing costs out-of-pocket. 1996 *Hearings*, *supra* note 2 (statement of Duncan A. Holaday, Assistant Secretary of the Navy,

is financially impossible for some young service members to afford civilian housing offering them a decent standard of living, and dilapidated military housing is their alternative.<sup>25</sup> This contributes to the decision by many service members to leave the military to seek a better quality of life in the civilian sector.<sup>26</sup>

The deterioration of military housing did not happen overnight. Shrinking budgets and the increasingly rigid procurement processes together have made major repair, renovation and replacement of houses virtually impossible.<sup>27</sup> Although defense budgets have increased in recent years, the scope of the problem cannot be resolved using traditional military construction funding and procurement methods.<sup>28</sup> Traditional methods of replacing and repairing military family housing are expensive, slow and cumbersome.<sup>29</sup>

The standard method of funding the repair and replacement of military family housing is through military construction dollars.<sup>30</sup> The Government owns houses built with military construction dollars, and is responsible for their operation and maintenance.<sup>31</sup> Since 1989, declines in defense budgets have impaired the ability of the Services to make needed repairs to deteriorating military housing.<sup>32</sup>

The costs to repair, replace, operate and maintain military family housing are significant. In fiscal year 1997 alone, DoD spent \$3 billion to operate and maintain Government-owned and Government-leased housing.<sup>33</sup> Congress authorized an additional \$976 million that same year to construct and

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Installation and Facilities). The DoD estimates that 15% of military families living in housing in the civilian community are considered unsuitably housed because the cost of their housing is significantly higher than their BAH. 1998 GAO REPORT, *supra* note 6, at ch. 1:1. A DoD-sponsored initiative would increase BAH for service members each year and eliminate the gap between actual housing costs and the housing allowance by 2005. 2000 *Hearings*, *supra* note 7 (statement of Randall A. Yim, Deputy Under Secretary of Defense, Installations).

<sup>25</sup> 1996 *Hearings*, *supra* note 2 (statement of Paul W. Johnson, Deputy Assistant Secretary of the Army, Installations and Housing).

<sup>26</sup> 1999 *Hearings*, *supra* note 22 (statement of Randall A. Yim, Acting Deputy Under Secretary of Defense, Installations).

<sup>27</sup> 1996 *Hearings*, *supra* note 2 (statement of Paul W. Johnson, Deputy Assistant Secretary of the Army, Installations and Housing).

<sup>28</sup> 1996 *Hearings*, *supra* note 2 (statement of Duncan A. Holaday, Assistant Secretary of the Navy, Installation and Facilities).

<sup>29</sup> 1998 GAO REPORT, *supra* note 6, at ch. 1:2.1.

<sup>30</sup> Each year Congress appropriates funds for military housing construction for each of the armed services. *See, e.g.*, Military Construction Appropriations Act for Fiscal Year 2002, Pub. L. No. 107-64, 114 Stat. 474 (Nov. 2001) (providing specific appropriations for family housing operation and maintenance and construction). In that Act, Congress appropriated funds for each department to use for construction of military family housing, to include its acquisition, replacement, addition, expansion, extension and alteration.

<sup>31</sup> 1998 GAO REPORT, *supra* note 6, at ch. 2:2.

<sup>32</sup> 1996 *Hearings*, *supra* note 2 (statement of Duncan A. Holaday, Assistant Secretary of the Navy, Installation and Facilities).

<sup>33</sup> 1998 GAO REPORT, *supra* note 6, at ch. 1.

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renovate family housing units.<sup>34</sup> Although a significant amount of money, it is woefully inadequate considering that it costs the Government an estimated \$123,550 to construct one new housing unit using military construction dollars.<sup>35</sup> Renovation of each existing unit costs the Government approximately \$65,700.<sup>36</sup> With over 300,000 family housing units in the DoD inventory, it is clear that traditional military construction dollars alone will not solve DoD's housing problem at anything faster than a snail's pace.

Traditional methods for acquiring family housing, as mentioned, are slow and cumbersome. Depending on the size of the project, it can take four or more years from conception to occupancy of units.<sup>37</sup> Government procurement processes require significant amounts of time to design the project, solicit potential contractors, negotiate, award the contract and construct the houses.<sup>38</sup>

Until recently, rigid statutory limitations also prescribed the type and quality of military family housing units provided to service members. For example, a member's pay grade controlled the number of bedrooms and square footage authorized.<sup>39</sup> Too, the individual Services have been free to add additional limitations, requirements and constraints on the construction or renovation of military family housing.<sup>40</sup>

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<sup>34</sup> *Id.*

<sup>35</sup> *Id.* at app. IV.

<sup>36</sup> *Id.* Operations and maintenance costs between \$6,000 and \$8,000 each unit, each year. *Id.* GAO also estimates that at year 25 after construction, every unit will require renovation costing \$65,700 per unit. *Id.*

<sup>37</sup> 1996 *Hearings*, *supra* note 2 (statement of Duncan A. Holaday, Assistant Secretary of the Navy, Installation and Facilities).

<sup>38</sup> In procurements for military family housing, the Government uses the methods set forth in the Federal Acquisition Regulation to acquire the housing needed. Title 48, C.F.R., hereinafter "FAR." The FAR applies to all acquisitions conducted by Government agencies for construction. FAR. 2.101 (Jan. 1, 2001). Traditionally, the Government conducts an acquisition to retain an architect and engineering firm to develop designs and specifications for housing units, indicating exactly how they are to be built. The Government then conducts another negotiated acquisition, issuing a solicitation structured under FAR Part 36 to obtain offers from construction contractors. Once received, the Government will negotiate with the offerors regarding the specifications of the project, price, and other factors, make a selection decision and award a contract to the offeror whose proposal represents the best value to the Government. The contractor then builds the houses on the installation.

<sup>39</sup> Prior to amendment on October 30, 2000, by section 2803(a)(1) of Public Law No. 106-398, 10 U.S.C. § 2826 provided that an O-6 (Colonel or equivalent) was entitled to a four bedroom home with a maximum of 1,700 square feet. An E-2 (junior enlisted) was entitled to two to five bedrooms depending on the number of children or other dependents, with square footage ranging from 920 square feet for a two-bedroom home to 1550 square feet for a five-bedroom home. *Id.*

<sup>40</sup> *See, e.g.*, U.S. DEP'T OF AIR FORCE, SECRETARY OF THE AIR FORCE INSTR. (AFI) 32-6002, FAMILY HOUSING PLANNING, PROGRAMMING, DESIGN AND CONSTRUCTION (27 May 1997) (limiting how funding may be used for amenities, renovations and repairs of family housing).



As a result of this highly regulated system, many contractors refuse to compete for contracts to build or renovate family housing.<sup>41</sup> Those that do compete often raise their prices to cover the higher costs associated with the Government procurement process and the statutory and regulatory requirements applicable to military family housing construction.<sup>42</sup> By 1995, it was clear that the military services needed new ways of doing business to reduce the cost to the Government and the time involved in acquiring acceptable housing for service members.

## **B. The Military Housing Privatization Initiative – Slow Beginnings In Different Directions**

By means of the National Defense Authorization Act for Fiscal Year 1996, Congress reacted to DoD's housing problem by enacting the MHPI.<sup>43</sup> In order to salvage military family housing, Congress provided DoD a variety of temporary authorities<sup>44</sup> to obtain private sector financing, expertise and management to repair, renovate, and construct military family housing.<sup>45</sup> In

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<sup>41</sup> 1998 GAO REPORT, *supra* note 6, at app. IV (Jul. 17, 1998).

<sup>42</sup> *Id.*

<sup>43</sup> 10 U.S.C.A. § 2871 (West 2002). Each Service has its own name for its housing privatization program under the 1996 authorities. The Army calls it the Residential Communities Initiative (RCI), formerly the Capital Venture Initiatives (CVI). 1999 *Hearings*, *supra* note 22 (statement of Mahlon Apgar, IV, Assistant Secretary of the Army, Installations and Environment). The Navy's program is the Public/Private Ventures (PPV) program. *Id.* (statement of Duncan Holaday, Deputy Assistant Secretary of the Navy, Installations and Facilities). The Air Force refers to it as the Military Housing Privatization Initiative (MHPI). 1996 *Hearings*, *supra* note 2 (statement of Jimmy Dishner, Deputy Assistant Secretary of the Air Force, Installations).

<sup>44</sup> The MHPI authority was initially given for a five-year test period ending February of 2001. 10 U.S.C. § 2885. In October 2000, Congress extended the authority until December 31, 2004. National Defense Authorization Act for Fiscal Year 2001, Pub. L. No. 106-398, § 2806, 114 Stat. 1654 (2000). In 2002, it was further extended until December 31, 2012. National Defense Authorization Act for Fiscal Year 2002, Pub. L. No. 107-107, § 2805, 115 Stat. 1012 (2001). The extension of authority is codified at 10 U.S.C.A. § 2885 (West 2002).

<sup>45</sup> *Id.* The conference report for the 1999 Appropriations Act for Military Construction, Family Housing, and Base Realignment and Closure for the Department of Defense makes clear that Congress intended the 1996 authorities to complement, not replace, traditional methods of providing adequate, safe and affordable family housing. H.R. REP. 105-647, 105<sup>th</sup> Cong., 2<sup>nd</sup> Sess., (1998). The committee stated specifically that

[t]he conferees strongly believe that the Department needs to use all available tools to address the family housing program in an optimum manner. This includes the traditional construction program, privatization, and adequate use of existing private sector housing. The conferees remind the Department that Congress approved the new privatization authorities as a pilot project, and that these authorities will expire on February 10, 2001. It was never the intent of the House and Senate Appropriations Committees for this program to become a substitute for the traditional housing construction program. *Id.*

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hearings on the legislation, DoD hailed it as a virtual panacea, providing a faster and cheaper method to obtain modern, affordable military family housing.<sup>46</sup> The MHPI authorizes direct loans and loan guarantees,<sup>47</sup> rental occupancy guarantees,<sup>48</sup> conveyance or lease of existing properties and facilities,<sup>49</sup> differential payments to supplement service members' housing allowances,<sup>50</sup> and investments such as limited partnerships and stock/bond ownership.<sup>51</sup> These authorities provide flexibility in structuring agreements with private developers to provide acceptable housing for service members. They enable the Services to draw upon private sector investment capital and housing construction expertise.<sup>52</sup> By using available Government assets, DoD seeks to entice the private sector to use its capital to invest in construction or renovation of military housing.<sup>53</sup> The Government can reduce the initial cost of construction, repair and renovation using MHPI authorities.<sup>54</sup>

In addition, the legislation exempts MHPI projects from many of the statutory and regulatory limitations applicable to military construction projects.<sup>55</sup> The MHPI houses must simply conform to similar housing units in the local community, allowing DoD to use commercial specifications,

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<sup>46</sup> 1996 *Hearings*, *supra* note 2 (statement of Robert E. Bayer, Deputy Assistant Secretary of Defense, Installations). Mr. Bayer stated that he believed that MHPI would "...result in faster construction of more housing built to market standards.... Commercial construction and operation is not only faster and less costly than military construction, but private sector funds will also significantly stretch and leverage the Department's limited housing resources, achieving more improved housing from the same funding level." *Id.*

<sup>47</sup> 10 U.S.C. § 2873.

<sup>48</sup> *Id.* § 2876.

<sup>49</sup> *Id.* § 2878.

<sup>50</sup> *Id.* § 2877.

<sup>51</sup> *Id.* § 2875. The legislation limits the Government's investment in an eligible private developer to 33 1/3% of the capital cost of the project, or 45% if the Government conveys land or facilities to the private developer. *Id.* § 2875(c). Government funding for investments in privatization projects comes from the Family Housing Improvement fund, created by the 1996 legislation. *Id.* § 2883. Military construction dollars appropriated to the Services may be transferred to this fund and used to fund the Government's contribution to the projects. *Id.*

<sup>52</sup> 2000 GAO REPORT, *supra* note 5.

<sup>53</sup> *Id.* Available assets may include existing housing units and land. 10 U.S.C. § 2878. It may also include BAH members are authorized to receive when renting MHPI housing units. *Id.* § 2882.

<sup>54</sup> 2000 GAO REPORT, *supra* note 5.

<sup>55</sup> For example, under 10 U.S.C. § 2880(b), the now-repealed limitations on space by pay grade that had been set forth in 10 U.S.C. § 2826 applied to all military construction projects for military housing, but were inapplicable to MHPI housing. *Supra*, note 39. The MHPI authority specifically exempts MHPI projects from the requirements of 10 U.S.C. § 2627 dealing with leases of non-excess Government property. *Id.* § 2878(d). In addition, MHPI projects are exempt from the provisions of the Federal Property and Administrative Services Act of 1949, 40 U.S.C. § 471, regarding the management and disposal of Government property, and Section 501 of the Stewart B. McKinney Homeless Assistance Act, 42 U.S.C. § 11411, requiring the use of suitable excess federal buildings and real property to assist the homeless. *Id.*

standards and construction practices rather than the traditional rigid requirements.<sup>56</sup> The hope is that this flexibility will streamline the process making houses available faster than under traditional methods.

The flexibility of MHPI has resulted in housing privatization projects with a variety of unique structures using one or a combination of authorities under the statute. The projects awarded so far demonstrate the range of possibilities. The MHPI project at Lackland Air Force Base (AFB), Texas, was awarded in August, 1998.<sup>57</sup> The project provided for 420 new housing units on the base by replacing 272 existing units and adding 148 new units.<sup>58</sup> The Government leased the land to the developer for a nominal rent, made a direct loan to the developer for \$10.6 million, and provided a guarantee for a private sector loan against base closure, downsizing and deployment.<sup>59</sup> The developer owns, operates and maintains the units for the fifty-year term of the lease.<sup>60</sup> Eligible service members referred to the developer by the Government rent directly from the developer.<sup>61</sup>

The Army's first MHPI project was at Fort Carson, Colorado, an installation in desperate need of housing rehabilitation, repair and new construction. In September 1999, the Army awarded the Fort Carson project for construction of 820 new units and renovation of 1,823 existing housing units, all situated on the installation.<sup>62</sup> Fort Carson executed an outright conveyance of the 1,823 existing units, signed a fifty-year lease of the land to the developer, and provided a loan guarantee for a private-sector loan.<sup>63</sup> Similar to the Lackland project, the developer owns, operates and maintains housing units and rents them directly to eligible soldiers.<sup>64</sup>

In 1996, the Navy entered into a ten-year limited partnership with a private housing developer to construct 404 units off the installation at Corpus

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<sup>56</sup> *Id.* § 2880(a). See also 1998 GAO REPORT, *supra* note 6, at ch. 1:2.1.

<sup>57</sup> 2000 *Hearings*, *supra* note 7 (statement of Randall A. Yim, Deputy Under Secretary of Defense, Installations).

<sup>58</sup> *Id.* See also 1998 GAO REPORT, *supra* note 6, at app. II.

<sup>59</sup> 2000 *Hearings*, *supra* note 7 (statement of Randall A. Yim, Deputy Under Secretary of Defense, Installations).

<sup>60</sup> *Id.* See also Lackland AFB Solicitation No. F41689-96-R0025, <http://www.afcee.brooks.af.mil/dc/dch/hpdata/hpdata.asp> (last visited Aug. 21, 2000) [hereinafter Lackland solicitation].

<sup>61</sup> Lackland solicitation, *supra* note 60. Rent for service members is capped at BAH. *Id.* at sec. 3.1.10. The Government does not provide any rental guarantees to the developer, and service members are not obligated to rent from the developer. *Id.* at sec. 1.0. It is possible for families other than active-duty families to occupy the houses, even members of the general public. *Id.* at sec. 3.1.9. The lease contains a priority list regarding who may occupy the houses if certain vacancy levels are reached. *Id.*

<sup>62</sup> 2000 *Hearings*, *supra* note 7 (statement of Randall A. Yim, Deputy Under Secretary of Defense, Installations).

<sup>63</sup> *Id.*

<sup>64</sup> Telephone Interview with Major (Maj) Dru Brenner-Beck, Chief, Administrative and Civil Law, Fort Carson, Colorado (Nov. 17, 2000) (notes on file with author). The Government provides no rental guarantees and rent is capped at BAH. *Id.*

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Christi, Texas.<sup>65</sup> The Navy provided \$9.5 million, and the developer financed the remainder of the \$32 million project.<sup>66</sup> At the end of the partnership, the Navy anticipates it will be repaid its equity share and receive one-third of the net value of the development.<sup>67</sup>

The military Services are also considering other types of arrangements for installations in the process of developing and awarding MHPI projects.<sup>68</sup> Although the flexibility to enter into these MHPI agreements was part of the legislation, the legislation left a large gap in terms of implementation guidance. It also left a variety of legal issues unanswered, and since implementation, the Services have been struggling to identify and resolve these issues.

### III. CONTRACT FORMATION ISSUES

Before any MHPI projects could commence, even before the first solicitation could be issued, the Services had to resolve a number of contract formation issues. This new MHPI authority appeared to offer the Services significant flexibility, but the Services were slow in deciding how to structure

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<sup>65</sup> 2000 *Hearings*, *supra* note 7 (statement of Randall A. Yim, Deputy Under Secretary of Defense, Installations). It should be noted that the Corpus Christi project was not constructed under MHPI authority, but under the limited partnership authority codified at 10 U.S.C. § 2837 that initially applied exclusively to the Navy, but was extended to all the Services in 1996. National Defense Authorization Act for Fiscal Year 1995, Pub. L. No. 103-337, § 2803(a)(1) (October 1994), as amended by Pub. L. No. 104-106, § 2802 (1996). See 2000 GAO REPORT, *supra* note 5. However, the Navy is now classifying those projects as MHPI projects. See Public Private Ventures, *Navy & Marine Corp Housing*, at <http://ppv.hsgnavfac.com/policy/>. The Navy is also now using Limited Liability Companies in place of the limited partnerships used in earlier projects. *Id.*

<sup>66</sup> 2000 *Hearings*, *supra* note 7 (statement of Randall A. Yim, Deputy Under Secretary of Defense, Installations).

<sup>67</sup> *Cf. id.*

<sup>68</sup> For example, the MHPI project at Elmendorf AFB, Alaska, includes an arrangement for repair, replacement and new construction resulting in 828 housing units owned, operated and maintained by the developer. Telephone Interview with Mr. Ted Franklin, Leased Housing Office Manager, Elmendorf AFB, Alaska (Jan. 5, 2001) (notes on file with author). The units currently needing no work will provide an immediate rental income stream for the developer. *Id.* They will also provide an available inventory for relocating families presently in units designated for renovation or demolition. *Id.* Elmendorf will convey 208 units needing no work and 200 units needing mid-level renovation to the developer. *Id.* The developer will demolish 56 existing units and construct 300 new units. *Id.* The project awarded at Dyess AFB, Texas in September of 2000, will be the first Air Force project located off the installation. The Dyess AFB project consists of a 402 housing unit complex located off the installation on land owned by the developer. Telephone Interview with Captain (Capt) Craig Crimmons, Chief, Contract Law, Dyess AFB, Texas (Feb. 7, 2001) (notes on file with author). The Navy has projects located off the installation in Texas and Washington. 1999 *Hearings*, *supra* note 22 (statement of Duncan Holaday, Deputy Assistant Secretary of the Navy, Installations and Facilities). The Navy projects did not use the MHPI authority, but were built pursuant to the 1995 authority at 10 U.S.C. § 2837 for the Navy to enter into limited partnerships. *Supra*, note 65.

the projects.<sup>69</sup> Fundamental questions of how to structure a solicitation, what kind of transaction, what kind of contract, what type of legal documents are required and what laws apply had to be resolved before the Services could move forward.<sup>70</sup>

Philosophically, the Services diverged on many of these issues. Perhaps not surprisingly, each Service attempted to exploit the flexibility of the new authorities and commercialize the acquisition process. The result was a partial divergence from the traditional procurement documents and procedures, with movement toward contractual arrangements and hybrid procedures. This section will examine the Army and Air Force approaches to contract formation in the new era of the MHPI.<sup>71</sup>

## A. FAR or Non-FAR Acquisition

### 1. Initial Assessments

The Services initially struggled with whether the Federal Acquisition Regulation (FAR), with all its limitations, restrictions and procedures, applied to MHPI transactions. By definition, the FAR applies to all “acquisitions.”<sup>72</sup> An acquisition is “the acquiring by contract with appropriated funds of supplies or services (including construction) by and for the use of the Federal Government through purchase or lease, whether supplies or services are already in existence or must be created, developed, demonstrated and evaluated.”<sup>73</sup>

The Air Force concluded that the FAR did not necessarily apply to a MHPI project.<sup>74</sup> The Air Force makes determinations as to its applicability on a case-by-case basis.<sup>75</sup>

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<sup>69</sup> 2000 GAO REPORT, *supra* note 5.

<sup>70</sup> *Id.*

<sup>71</sup> The Navy’s projects have by and large utilized limited partnership agreements under their special 1995 legislation. 2000 GAO REPORT, *supra* note 5. Although the Navy has awarded new projects under the MHPI authority consisting of phase II of the Corpus Christi, TX, and Everett, WA, projects, they will not be examined in this section.

<sup>72</sup> FAR, *supra* note 38, at 1.104.

<sup>73</sup> *Id.* at 2.101.

<sup>74</sup> Interview with Dorothy Loeb, Attorney, SAF/GCN, in Washington D.C. (Feb. 7, 2001) (notes on file with author).

<sup>75</sup> *Id.* In fact, the Air Force determined its first MHPI project at Lackland AFB was a real estate transaction not subject to the FAR. *Id.* FAR procedures and clauses generally are not applicable to but often are used in structuring real estate transactions. Cf. 48 C.F.R. Part 570. The Air Force concluded that this was a real estate transaction rather than a FAR transaction because the Air Force’s role in the project was nothing more than a commercial lessor of land. *Id.* This is distinguishable from a 1984 Air Force legal opinion from the Air Force General Counsel’s office that concluded privatization projects constructed under Section 801 of the FY84 Military Construction Authorization Act were subject to the FAR, and should comply with the FAR. Memorandum from Grant C. Reynolds, Assistant General Counsel to AF/RDC, subject: Hanscom AFB Build/Lease Housing Project (Nov. 27, 1984) (on file with author)

The Army concluded, however, that MHPI transactions were subject to the FAR.<sup>76</sup> As a result, the Army's first MHPI project was treated as a FAR transaction.<sup>77</sup>

In 1997, the Department of Defense General Counsel's office (DoD/GC) issued a memorandum providing guidance on whether MHPI initiatives are subject to the FAR. The memorandum stated that the applicability of the FAR to the use of the MHPI authorities depended on the specific authority used and the manner it was implemented.<sup>78</sup> The DoD/GC recommended that the Services determine whether each project involves the direct obligation of appropriated funds to directly acquire military housing or services, or direct involvement such that it constitutes an acquisition for goods and services by the Government.<sup>79</sup> If either of these criteria exists, then the FAR applies.<sup>80</sup> If not, the Services have the discretion to use any structure that is appropriate to carry out the intent of the project.<sup>81</sup> The Services have used their discretion to creatively structure the necessary procurement documents and processes.

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[hereinafter Reynolds Memo]. That opinion was based on the specific language in the Act and the financial and contractual structure of those projects. *Id.* The same reasoning cannot be extended to the MHPI legislation.

<sup>76</sup> Memorandum from Harvey J. Nathan, Deputy General Counsel (Acquisition & Logistics) to the Deputy Under Secretary of Defense (Industrial Affairs & Installations), subject: Alternative Authority for Acquisition and Improvement of Military Housing; Applicability of the Federal Acquisition Regulation (Mar. 5, 1997) (on file with author) [hereinafter Nathan FAR Memo].

<sup>77</sup> Fort Carson was the Army's first MHPI project. The Army concluded the FAR was applicable and preferable because the project involved conveyance of existing units to the developer and a contractual instrument was the central element of their project. *Id.* The Army also felt that having a FAR contract would simplify modifications over the term of the agreement and provide greater oversight of the developer's performance. *Id.*

<sup>78</sup> *Id.* In discussing the Lackland and Fort Carson projects, the DoD/GC recognized that they were nearly identical in their overall structures. *Id.* In both projects, the developer would construct and/or rehabilitate the housing units and lease them directly to service members. *Id.* The developer is conveyed title to existing houses and has title in newly constructed units. *Id.* The Government leases land to the developer for the housing project. *Id.* In both projects, tenants pay rent directly to the developer, and the Government does not provide occupancy guarantees. *Id.* The units are built to broad Government requirements and the Government conducts inspections. *Id.* Appropriated funds are provided to the developer in the form of a loan or loan guarantee. *Id.* The DoD/GC characterized the role of the military department as that of a "facilitator" marrying a private developer with prospective military housing occupants. *Id.* The DoD/GC concluded that use of the FAR was not required in either project. *Id.*

<sup>79</sup> *Id.*

<sup>80</sup> *Id.*

<sup>81</sup> This is not to say that if the FAR does not apply, the Services must abandon the FAR structure entirely. In fact, the Air Force routinely uses language from FAR clauses, but not the actual FAR clause itself, in their MHPI solicitations. *See, e.g.,* Lackland solicitation, *supra* note 60. In addition, the Lackland project used a competitive source selection procedure that mirrored those contemplated under the FAR. *Id.*

The solicitations for the first two MHPI projects (at Lackland Air Force Base, Texas and Fort Carson, Colorado) were similar to traditional FAR-type solicitations.<sup>82</sup> Competitive procedures were used, and both proceeded through a source selection process similar to a traditional FAR procurement.<sup>83</sup> However, after these initial solicitations, both Services varied the processes for soliciting and selecting a developer.

## 2. *The Air Force Three-Step Negotiation Process*

The Air Force continued to use a FAR-type solicitation, and this process is now the standard in the Air Force. For example, a later solicitation at Elmendorf Air Force Base utilized a streamlined non-FAR solicitation for maximum flexibility in proposal development.<sup>84</sup> The first step was submission of the offeror's proposal containing the proposed legal and financial structure; design and development plan for individual units and housing community; real estate management plan, to include facility maintenance and capital repair and replacement; and past performance information.<sup>85</sup> The proposals were then evaluated and ranked in accordance with the criteria outlined in the solicitation.<sup>86</sup> Only the highest ranked offeror proceeded to step two of the process, negotiations with the Government.<sup>87</sup>

If the parties had failed to reach an acceptable agreement within a reasonable period of time, the Government would have terminated negotiations with that offeror and commenced negotiations with the next highest ranked

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<sup>82</sup> Unlike the solicitations used at Fort Carson and another early Army MHPI project at Fort Hood, FAR clauses are notably absent from the Lackland solicitation. *See id.*

<sup>83</sup> *See* E-mail from Major Dru Brenner-Beck, Chief, Administrative and Civil Law, Fort Carson, Colorado to author (Feb. 1, 2001, 11:23 AM) (on file with author); Lackland solicitation, *supra* note 60, at sec. 2.0(d). Generally this includes an evaluation of proposal received in response to the solicitation, with an initial evaluation determining which proposals are in the competitive range. Offerors in the competitive range then engage in discussions with the Government and submit Best and Final Offers. The contract is awarded to the offeror who represents the best value to the Government based on the evaluation criteria. The Lackland project added an initial qualification step that required potential offerors to submit documentation showing they had the requisite financial capacity and technical expertise to develop, own, finance and operate a large housing community. Lackland solicitation, *supra* note 60, at sec. 2.0(d). The Fort Carson project proceeded as a typical FAR procurement source selection. Irregularities in the source selection process, deviations from stated criteria and an eventual competitive range of one offeror resulted in a protest of the solicitation. *Pikes Peak Family Hous. v. United States*, 40 Fed. Cl. 673 (1998).

<sup>84</sup> Elmendorf AFB, Solicitation No. FXSB2001-00-01, at sec. 5.1.1, <http://www.eps.gov> (last visited Jan. 15, 2001) [hereinafter Elmendorf solicitation].

<sup>85</sup> *Id.* at sec. 5.2. This initial submission contains all the information that is required in a typical FAR proposal.

<sup>86</sup> *Id.* at sec. 5.1.2.1.

<sup>87</sup> *Id.* at sec. 5.1.2.2.

offeror.<sup>88</sup> This would have been repeated until an acceptable agreement was reached.

Step three consisted of finalizing the financing and implementing the agreement.<sup>89</sup> This three-step solicitation and other unique processes to “commercialize” traditional procurement processes are likely to undergo continued exploration as the Air Force develops MHPI projects.<sup>90</sup>

### 3. *The Army Three-Step Request for Qualification Process*

Following the project at Fort Carson, the Army has engaged its own creative tools to attempt to commercialize and streamline the traditional FAR process. Fort Hood was the first to use the Request for Qualification (RFQ) process in lieu of the traditional Request for Proposals (RFP).<sup>91</sup> The benefits of the RFQ over the traditional RFP are that it is simpler and less expensive for developers, allows flexibility in project development, maximizes opportunities

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<sup>88</sup> *Id.*

<sup>89</sup> *Id.* at 5.1.2.2, 5.1.2.3.

<sup>90</sup> The more recent Air Force MHPI solicitations contemplate a slightly modified procedure. There is an initial pre-qualification of offerors and no more than five are selected to compete for the project. Those pre-qualified offerors then compete for the final award.

The Air Force is currently developing a template Request for Proposals document as well as standardizing all the documents used in MHPI transactions. The Air Force has also engaged the assistance of outside consultants in the MHPI process. The Air Force Center for Environmental Excellence (AFCEE) has been designated as the Housing Privatization Center of Excellence. Distribution Memorandum from Gary M. Erickson, Director, AFCEE, subject: Final Charter, Air Force Center for Environmental Excellence (AFCEE), Housing Privatization Center of Excellence (Worldwide Action Item 98-6) (Jul. 7, 1999) (on file with author). AFCEE is analogous to the Army Corps of Engineers in that it is a DoD organization chartered to provide advisory and assistance services on a reimbursable basis, in AFCEE’s case to Air Force organizations concerning a number of environmental, utility and housing privatization issues. An installation involved in a MHPI project can choose to use AFCEE or hire outside consultants if expertise is not available at the installation or Major Command. AFCEE has developed a Privatization Support Contractor (PSC) program. Telephone Interview with Gordon Tanner, Legal Counsel, Air Force Center for Environmental Excellence (Jan. 23, 2001) (notes on file with author).

PSCs are companies with real estate and commercial development expertise that can provide consultant services to installations slated for MHPI projects. *Id.* Each PSC is selected through FAR competitive procedures and has a FAR contract with AFCEE. *Id.* These PSCs are designed to be the arms and legs of the Air Force in privatization projects. *Id.* Once the Air Force decides and specifies what it needs, the PSC ensures that plan is compatible with base and local community standards and is provided to the public in language that is easy for the commercial sector to understand. *Id.* The PSC can assist, recommend or review financial structures and debt transactions. *Id.* The PSC will then seek out capable and interested developers. *Id.* The Air Force supervises the PSC and makes the ultimate selection decision, but the process is significantly more flexible and streamlined than anything the Air Force has done previously. *Id.*

<sup>91</sup> See Fort Hood, Request for Qualifications, <http://www.rci.army.mil/rfq/> [hereinafter Fort Hood RFQ].



for innovation, and enables the Army to achieve the best financing and highest return on investment.<sup>92</sup>

The RFQ is fundamentally a three-phase process.<sup>93</sup> During the first phase, developers submit a Statement of Qualifications that contains sufficient detail to enable the Government evaluators to reach a reasoned judgment as to the developer's experience and overall capability to perform.<sup>94</sup> The Statements are evaluated according to specified criteria. The developer demonstrating a capability to perform whose submission is most advantageous to the Government is selected.<sup>95</sup>

The selected developer then moves into phase two, working closely with the Army to develop a Community Development and Management Plan (CDMP). The CDMP sets forth the details of the project, including scope, design, management and legal and financial structure.<sup>96</sup> If the developer completes this phase, the Army pays it \$350,000 and receives unlimited rights to use the CDMP.<sup>97</sup> If the Army is dissatisfied with the CDMP, it releases the developer following the \$350,000 payment.<sup>98</sup> If the Army accepts the CDMP, the developer implements it under the third phase.<sup>99</sup> Fort Hood has entered this latter stage and will be the first Army installation to complete the entire process using an RFQ.<sup>100</sup>

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<sup>92</sup> 1999 *Hearings*, *supra* note 22 (statement of Mahlon Apgar, IV, Assistant Secretary of the Army, Installations and Environment).

<sup>93</sup> Fort Hood RFQ, *supra* note 91, at pt. I, sec. 1.1. Note that the RFQ is organized into two phases, a project planning phase and a project implementation phase. In the discussion that follows, the initial project planning phase is conceptually described as consisting of two phases: submission of a Statement of Qualifications and development of a Community Development and Management Plan.

<sup>94</sup> *Id.* at pt. I, sec. 4.1. The RFQ requires the Statement to demonstrate the developer meets the minimum experience requirements set forth in the RFQ. *Id.* at pt. I, sec. 4.2. In addition, it requires a detailed listing of relevant experience, preliminary concept statement, documentation of financial capability, background and structure of the developer's organization, past performance information, statement of expected financial return on the project and information regarding the developer's use of small business concerns as subcontractors. *Id.* at pt. I, sec. 4.3. This information is similar in type to the information required in an RFP, but is significantly less detailed and therefore less expensive for developers to prepare. An RFP details explicitly the project requirements, and the Government selects the contractor based on what is contained in the developer's proposal. 1999 *Hearings*, *supra* note 22 (statement of Mahlon Apgar, IV, Assistant Secretary of the Army, Installations and Environment). In contrast, the idea of the RFQ is to formulate explicit criteria for selecting the developer and then work jointly with the developer to devise the best plan for project execution. *Id.*

<sup>95</sup> Fort Hood RFQ, *supra* note 91, at pt. I, sec. 4.0.

<sup>96</sup> *Id.* at pt. I, sec. 1.1.

<sup>97</sup> *Id.*

<sup>98</sup> *Id.*

<sup>99</sup> *Id.*

<sup>100</sup> E-mail from Mike Finn, Staff Judge Advocate, Fort Hood, Texas to author (Nov. 30, 2000, 4:36 PM) (on file with author). The project status page at the DUSD(I&E)'s Military Housing

The RFQ process is unique and, because it has not yet been tested on many projects, its effectiveness and usefulness are still unknown.<sup>101</sup> In addition to practical questions regarding the RFQ's effectiveness, questions about its legal permissibility remain unanswered. The Army has largely structured its MHPI projects as FAR transactions. More recent RFQ's state that the FAR applies only to phase one of each project, which is when the selected developer works with the Army to create a CDMP. The RFQ contains FAR numbered clauses, further indicating a FAR transaction.<sup>102</sup>

If the Army has determined the FAR applies because MHPI is an acquisition of goods and services using appropriated funds, then the FAR would apply to the solicitation and source selection process as well.<sup>103</sup> There are no explicit provisions in the FAR for the RFQ process. The FAR clauses in the RFQ indicate it is being treated as a commercial item acquisition.<sup>104</sup> Commercial acquisitions should be made competitively and may be accomplished through the use of negotiated procedures.<sup>105</sup>

The RFQ process appears to be a hybrid between a sole source acquisition and a negotiated procurement with a competitive range of one. Developers compete in the first qualification phase based on a virtually non-existent statement of Government needs and non-specific evaluation factors. It is difficult to understand how effective competition can be achieved using the

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Privatization web site reports that transfer of operations to the private developer took place on October 1, 2001. *Supra*, note 2.

<sup>101</sup> The RFQ process unquestionably saves the potential offerors time and money initially, but the selected developer is taking significant risks. Judging from Fort Hood's experience, the selected developer spends many times the \$350,000 sum to prepare the CDMP, so if an agreement cannot be reached, the developer suffers a significant loss. E-mail from Mike Finn, *supra* note 100. That has not happened at Fort Hood, but the selection of the developer in June of 2000 failed to immediately yield a final acceptance of the CDMP, which did not occur until some months later. E-mail from Mike Finn, Office of the Staff Judge Advocate, Fort Hood, Texas, to author (Nov. 14, 2000, 5:34 PM) (on file with author); project status page at the DUSD(I&E)'s Military Housing Privatization web site, *supra*, note 2. This raises questions regarding whether the RFQ process is any faster or more streamlined than the traditional FAR process. Fort Lewis and Fort Meade MHPI projects were solicited using the RFQ process. See Office of the Assistant Secretary of the Army for Installations and the Environment, *The Army's Residential Communities Initiative*, at <http://www.rci.army.mil>. In addition, the Army is combining projects into a large multi-project RFQ that allows developers to submit offers for one or more of the projects included in the RFQ. *Id.* For example, several projects for the northeast were wrapped into one RFQ that included MHPI projects at Fort Detrick, Maryland; Fort Hamilton, New York; Picatinny Arsenal, New Jersey; and Walter Reed Army Medical Center, District of Columbia. *Id.*

<sup>102</sup> Fort Hood RFQ, *supra* note 91, at pt. II, app. E. For example, the RFQ includes FAR clause 52.212-1, Instructions to Offerors – Commercial Items; and FAR clause 52.212-2, Evaluation Commercial Items. *Id.*

<sup>103</sup> See *supra* Part III.A.

<sup>104</sup> Fort Hood RFQ, *supra* note 91, at pt. II, app. E.

<sup>105</sup> FAR, *supra* note 38, at 12.203.

very general requirements and evaluation criteria as in the Fort Hood RFQ.<sup>106</sup> In addition, after this initial competition, only one developer is selected to negotiate with the Army for the right to be awarded the contract.<sup>107</sup> This appears to be nothing more than selecting a competitive range of one, a process subject to close judicial scrutiny when challenged.<sup>108</sup>

Although the Army's RFQ process has not been challenged to date, there is some question as to whether it would be found legally permissible if challenged. The simple solution would be an Army determination that the FAR is not applicable to future MHPI projects, but that inclusion of language from FAR provisions is permissible where in the Army's best interests. If MHPI projects are properly conducted outside of the FAR, new and flexible processes such as the RFQ can be further developed with a reduced risk of legal challenge.

## B. Applicable Procurement Statutes

One of the more difficult tasks in moving from traditional procurement processes to new processes instituted under the MHPI authority is the application of various statutes to MHPI projects and contractual arrangements.<sup>109</sup> Whether or not the FAR applies, there are a number of federal statutes that form the basis of most of the FAR provisions. It is a separate inquiry for each project as to which statutes apply to the project. The Davis-Bacon Act and the Contract Disputes Act of 1978 (CDA) have received considerable attention: there is a general consensus that Davis-Bacon applies to MHPI agreements, or at least the current policy is to include Davis-Bacon in the agreements;<sup>110</sup> there is no consensus regarding the applicability of CDA to MHPI agreements.<sup>111</sup>

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<sup>106</sup> Competing developers on the Fort Hood project referred to the RFQ process as a beauty contest. E-mail from Mike Finn, *supra* note 101.

<sup>107</sup> Fort Hood RFQ, *supra* note 91, at pt. I, sec. 4.0.

<sup>108</sup> *Pikes Peak Family Hous. v. United States*, 40 Fed. Cl. 673, 678 (1998); *Birch & Davis Int'l Inc. v. Christopher*, 4 F.3d 970, 974 (Fed. Cir. 1993).

<sup>109</sup> For example, Fort Hood grappled with the applicability of Housing and Urban Development statutes requiring comprehensive lead paint abatement procedures upon the sale of Federal housing. E-mail from Mike Finn, Fort Hood Office of the Staff Judge Advocate, *supra* note 100. They determined that as long as the conveyance was not a "sale" the statutes did not apply. *Id.* A number of environmental and other statutes are potentially applicable to MHPI projects, and their impact on MHPI projects may not be known until litigation is initiated.

<sup>110</sup> The Air Force has not provided a written legal opinion indicating that Davis-Bacon applies to MHPI agreements, but as a matter of policy, it has included Davis-Bacon in all MHPI solicitations to date. Interview with Dottie Loeb, *supra* note 74.

<sup>111</sup> The Contract Disputes Act of 1978 is codified at 41 U.S.C.A. §§ 601-613 (West 2001). The Army has consistently included the CDA clause in its RFQ. *See, e.g.*, Fort Hood RFQ, *supra* note 91, at pt. II, app. E, FAR clause 52.212-4(d). The Air Force policy is that the CDA is not applicable to MHPI projects. Interview with Dottie Loeb, *supra* note 74.

## 1. Davis-Bacon Act

The Davis-Bacon Act requires that every contract (to which the United States is a party) in excess of \$2,000 for construction, alteration, and/or repair of public buildings or public works shall state the prevailing wage rate to be paid laborers and mechanics as determined by the Secretary of Labor.<sup>112</sup> The Act itself does not define “public building” or “public work”; however, Department of Labor regulations define a “public work” as a “building or work, the construction, prosecution, completion or repair of which...is carried on directly by authority of or with funds of a Federal agency to serve the interest of the public regardless of whether title thereof is in a Federal agency.”<sup>113</sup> This language has been broadly construed to apply Davis-Bacon to a number of contractual arrangements that appear to be clearly outside the plain language of the statute. Indeed, it has been held that Davis-Bacon applies to work done on property belonging to the United States and to all fixed work constructed for public use at the expense of the United States.<sup>114</sup>

In a bid protest decision addressing the applicability of Davis-Bacon to Section 801 privatized housing, the General Accounting Office (GAO) found that Davis-Bacon applied to Section 801 contracts.<sup>115</sup> Specifically, the GAO found that Davis-Bacon applied because the housing was for a public purpose (to house military families) and the construction costs were essentially being reimbursed through lease payments.<sup>116</sup>

While the MHPI projects are different from Section 801 housing in that, under MHPI, the Government does not provide direct lease payments to the contractor, the Government does nonetheless provide MHPI contractors funding through direct loans or loan guarantees to finance construction.<sup>117</sup> This appears to fall within the scope of Davis-Bacon. Moreover, Davis-Bacon has been interpreted to encompass any construction that would not have been

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<sup>112</sup> 40 U.S.C.A. § 276a (a) (West 2001).

<sup>113</sup> 29 C.F.R. § 5.2(k) (2001).

<sup>114</sup> Peterson v. United States, 119 F.2d 145 (6th Cir. 1941).

<sup>115</sup> Fischer Eng'g. & Maint. Co., Comp. Gen., B-223359, Sep. 26, 1986, 86-2 CPD ¶ 359. Section 801 housing projects were typically a build/lease arrangement. Military Construction Authorization Act for Fiscal Year 1984, Pub. L. No. 98-115 § 801, 97 Stat. 757, 782-83 (codified at 10 U.S.C. § 2828) (repealed 1991). Generally, the Government leased the land to the developer and the developer built new units that the developer owned. *Id.* The Government then leased the houses directly from the developer at a set rate and used the houses for military families. *Id.* Appropriated funds were used to pay rent. *Id.*

<sup>116</sup> *Id.*

<sup>117</sup> The Government provided a direct loan to the developer in the Lackland MHPI project, in addition to loan guarantees. 2000 *Hearings, supra* note 7 (statement of Randall A. Yim, Deputy Under Secretary of Defense, Installations). The Fort Carson MHPI project utilized a loan guarantee. *Id.* The Navy projects, although constructed under a different authority, required the Navy to provide an equity contribution to the projects of \$9.5M on the Corpus Christi, Texas, project and \$5.9M on the Everett, Washington, project. *Id.*

accomplished by the private developer but for its contract with the agency.<sup>118</sup> Applying the same reasoning to MHPI projects, the private developers would not engage in the housing construction and renovation but for the Federal authority and direction. Therefore, it appears compliance with the Davis-Bacon Act will be required in MHPI projects unless a unique contractual or financial arrangement takes it outside the purview of the statute.

## 2. *Contract Disputes Act*

The second statute for which applicability is in question is the Contract Disputes Act of 1978 (CDA).<sup>119</sup> The CDA applies to express or implied contracts entered into by an executive agency for procurement of property, services, construction, alteration, repair or maintenance of real property or disposal of personal property.<sup>120</sup> The CDA does not apply to procurement of real property in being, but the Act is silent regarding the disposal of real property.<sup>121</sup> The Army has specifically made its MHPI contracts subject to the CDA through insertion of a CDA clause in the MHPI contract.<sup>122</sup>

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<sup>118</sup> Comp. Gen., B-234896, (Jul. 19, 1989)(available through FLITE database)(holding development agreements under the Judiciary Building Act were subject to Davis-Bacon wage rates because the building would serve the general public and it would not have been built by the developer on federal land without the authority). The GAO has recognized the cases indicating a broad construction for applicability of Davis-Bacon Act (DBA) to a number of contracts involving some type of construction. While the U.S. Department of Justice's Office of Legal Counsel initially believed the DBA was *per se* not applicable to any lease contract (regardless of whether such a contract also called for construction of a public work or building), it has since concluded that the applicability of the DBA to any specific lease contract depends upon the facts of the contract at issue. Reconsideration of Applicability of the Davis-Bacon Act to the Veteran Administration's Lease of Medical Facilities, 18 Op. Off. Legal Counsel 109 (May 23, 1994)("determination whether a particular lease-construction contract is a 'contract . . . for construction' of a public work or building within the meaning of the Davis-Bacon Act will depend upon the details of the particular agreement"), *available at* <http://www.usdoj.gov/olc/1994opinions.htm>.

<sup>119</sup> 41 U.S.C.A. § 601-613 (West 2001). The CDA provides a framework for resolving disputes between Government agencies and Government contractors following award of a contract. *See* FAR, *supra* note 38, at subpt. 33.2. One key feature is its procedural requirements prior to allowing contractors to seek redress at a Board of Contract Appeals (BCA) or the Court of Federal Claims. 41 U.S.C. A. § 605. In addition, the CDA vests jurisdiction in the agency BCAs to resolve disputes between the parties to the contracts. *Id.* at § 607.

<sup>120</sup> *Id.* at § 602(a).

<sup>121</sup> *Id.*

<sup>122</sup> *See, e.g.,* Fort Hood RFQ, *supra* note 91, at pt. II, app. E, FAR clause 52.212-4(d). The only question is when the CDA becomes applicable in the context of the RFQ. Generally, the CDA only applies to disputes arising after award. *United States v. John C. Grimberg, Inc.*, 702 F.2d 1362 (Fed. Cir. 1983). The phased method under the RFQ, where one developer is selected and proceeds into further negotiations resulting in a final agreement, may constitute two different awards and therefore two different contracts. The first award and contract occurs when the developer is selected and awarded the right to develop the CDMP and to receive

In contrast to the Army's inclusion of the CDA in its solicitations, Air Force solicitations issued to date do not contain such provisions. The Air Force position is that MHPI agreements are not subject to the CDA because the agreement is for the disposal of real property.<sup>123</sup> While the CDA specifically covers disposal of personal property, it is silent regarding disposal of real property.<sup>124</sup> The only case directly addressing the applicability of the CDA to a federal agency's disposal of real property to a private party is *Korman Corporation*,<sup>125</sup> out of the Housing and Urban Development Board of Contract Appeals.

In that case, Housing and Urban Development (HUD) entered into a contract with a private contractor for the bulk sale of 120 houses.<sup>126</sup> The contract required the contractor to rehabilitate all of the houses within 180 days, in accordance with the repair specifications in the contract.<sup>127</sup> Once HUD inspected and approved the repairs, it was to issue a commitment to insure the mortgage of each of the properties, which would be sold to lower

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consideration for doing so. This first award appears to fall squarely within the act as procurement of services. 41 U.S.C. § 602(a)(2). The Army is procuring a CDMP for \$350,000 that the Army has the full right and title to use if it terminates negotiations with the developer. That being true, any disputes that may arise during the CDMP development phase, including the Army's decision to terminate the negotiations, would appear to be subject to the CDA procedural requirements and ultimately to jurisdiction of the Armed Services Board of Contract Appeals (ASBCA). The second award and contract occurs when the Army accepts the developer's completed CDMP and proceeds to phase three to implement the plan. As is typical in traditional procurement contracts, any disputes that arise during the term of the contract will be subject to CDA requirements and will fall under the jurisdiction of the ASBCA.

<sup>123</sup> Interview with Dottie Loeb, *supra* note 74. Interestingly, the Elmendorf solicitation contained a unique disputes clause that varies significantly from the CDA. Elmendorf solicitation, *supra* note 84, at app. I, para. 23. It provides that disputes under \$10,000 will be decided by the Commander whose decision is final and conclusive and not otherwise appealable or subject to challenge. *Id.* at app. I, para. 23.1. For disputes over \$10,000, the developer must exhaust its administrative remedies. *Id.* at app. I, para. 23.2. Exhaustion of administrative remedies includes submission to the Commander for a decision that is final unless appealed to the Secretary of the Air Force within 30 days of the date the developer receives the Commander's written decision. *Id.* at app. I, para. 23.2.1. If timely appealed to the Secretary, the Secretary's decision is final unless appealed to a court of competent jurisdiction in a timely manner. *Id.* at app. I, para. 23.2.2. What is "timely" and what is a "court of competent jurisdiction" are not defined anywhere in the MHPI agreement. Once the developer exhausts its administrative remedies, it may "pursue any remedy available to it under the law" and/or submit to alternative dispute resolution with the Government. *Id.* at app. I, para. 23.3. This is now the standard clause used by the Air Force in MHPI projects. Air Force Generic RFP, Operating Agreement to the Lease, Condition 24, <http://www.afcee.brooks.af.mil/dc/dcp/news/download/genericrfp.pdf> (last visited April 1, 2002). Unlike the provisions of the CDA, the process set forth under this clause leaves a number of questions unanswered, such as timing, jurisdiction, and procedure.

<sup>124</sup> 41 U.S.C. § 602(a)(4).

<sup>125</sup> *Korman Corp.*, HUD BCA No. 81-563-C5, 82-2 BCA ¶ 16,044 (Sep. 26, 1982).

<sup>126</sup> *Id.*

<sup>127</sup> *Id.*

income citizens.<sup>128</sup> The contract did not contain the CDA disputes clause or any other indication the contract was subject to the CDA.<sup>129</sup>

The Board of Appeals found the contract was a dual purpose contract covering both the sale of 120 houses and the repair of the houses.<sup>130</sup> The repair portion of the contract was found to be directly encompassed within the CDA. The Board then considered the CDA's silence with respect to its applicability to the sale or disposal of real property<sup>131</sup> and concluded the primary purpose of the contract was for rapid repair of the houses to enable them to be sold to low income families.<sup>132</sup> The sale of the units to the private contractor was incidental to the repair.<sup>133</sup> In reaching this conclusion, the Board noted the contractual control reserved by the Government over the inspection and approval of the repairs even after the conveyance.<sup>134</sup> Finding repair to be the primary purpose of the contract, the Board concluded the CDA applied to the contract, and that it had jurisdiction to hear the dispute.<sup>135</sup>

In the case of MHPI projects, the primary purpose is to provide financial incentives to developers to repair and construct houses for occupancy by active-duty service members.<sup>136</sup> The conveyance of the houses and lease of the land to the developer are largely incidental to the construction and repair portions of the agreement. In addition, under most MHPI agreements, the

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<sup>128</sup> *Id.*

<sup>129</sup> *Id.*

<sup>130</sup> *Id.*

<sup>131</sup> *Id.*

<sup>132</sup> *Id.* The board also noted that other agency boards of contract appeals had considered their jurisdiction over hybrid contracts involving elements of CDA covered and non-covered matters. *Id.* (citing *Lea Co.*, GSBICA No. 5697, 81-2 BCA ¶ 15,207 (Jun. 25, 1981); *Sierra Pacific Indust.*, AGBCA No. 79200, 80-1 BCA ¶ 14,383 (Apr. 11, 1980)). In those cases, the boards determined the contracts were subject to the CDA. In *Lea Company*, the board determined that a Government lease of an interest in real property was a contract and that the board had jurisdiction to hear the dispute under the CDA. *Lea Co.*, 81-2 BCA ¶ 15,207. In *Sierra Pacific Industries*, the contract at issue involved the sale of timber and the construction of a road. Although the board decided the case based on a determination that the sale of timber constituted disposal of personal property therefore subjecting the contract to the CDA and the board's jurisdiction, the board suggested that the road construction portion of the contract may have been sufficient to subject it to the CDA. *Sierra Pacific Indust.*, 80-1 BCA ¶ 14,383; *see also* *Forman v. United States*, 767 F.2d 875 (Fed. Cir. 1985) (holding that even if lease is not subject to CDA, lease was part of larger contract with private party to construct a building for the Post Office making the entire contract subject to the CDA).

<sup>133</sup> *Korman Corp.*, 82-2 BCA ¶ 16,044.

<sup>134</sup> *Id.*

<sup>135</sup> *Id.* The board noted that the CDA is sufficiently broad to encompass contracts that have one or more of the enumerated procurement purposes that are specifically covered by the CDA. *Id.* *But see* *Bonneville Assocs. v. United States*, 43 F.3d 649 (Fed. Cir. 1994) (suggesting that the CDA may be applicable to dual purpose contracts only if the dispute arises under the purpose covered by the CDA).

<sup>136</sup> The statute authorizing MHPI indicates the purpose of the statute is to provide for the acquisition or construction of family housing units on or near military installations in the United States, its territories and possessions by private developers. 10 U.S.C. § 2872.

Government continues to exercise approval authority over designs and specifications and provides inspections during construction.<sup>137</sup> Thus, under the reasoning in *Korman*, the CDA applies to MHPI agreements, and a board of appeals would likely assume jurisdiction over any disputes arising under the agreements.<sup>138</sup>

#### IV. ISSUES DURING CONTRACT PERFORMANCE

Once the MHPI project is finalized, and the developer begins performance, the installation takes over administration of the agreement.<sup>139</sup>

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<sup>137</sup> For example, under the Elmendorf solicitation, the developer and the Government participate in a 35%, 65% and 100% design review conference, with the Government retaining the right to accept or reject the final plans. Elmendorf solicitation, *supra* note 84, at sec. 3.2.6.1. In addition, the developer must receive a Certificate of Occupancy from the Government before occupying the units. *Id.* at sec. 3.2.6.5. The Government will only provide the Certificate once it is satisfied the developer has complied with all applicable codes, standards, regulations, drawings, plans and specifications. *Id.* The Lackland solicitation sets forth pervasive mandatory Government inspection requirements. Lackland solicitation, *supra* note 60, at app. A, exhibit G. In the Fort Hood MHPI project, the Army works with the developer to plan the project including its design, and reserves the right to accept or reject the developer's plan. Fort Hood RFQ, *supra* note 91, at pt. I, sec. 2.1.

<sup>138</sup> By way of analogy, this conclusion is similar to that regarding the applicability of bid protest jurisdictional provisions of the Competition in Contracting Act of 1984 (CICA), 31 U.S.C. § 3551, to dual purpose contracts. In a 1999 bid protest before the GAO, the GAO determined that a contract for privatization of government utilities was a dual purpose contract. Government of Harford County, Maryland, B-283259, B-283259.3, Oct. 28, 1999, 99-2 CPD ¶ 81. The contract in that case was for the sale of Aberdeen Proving Ground's water and wastewater treatment facilities and the provision of potable water and wastewater services. *Id.* The Army argued that GAO had no jurisdiction to resolve the protest because the RFP was for the sale or transfer of government property, not for the procurement or award of a contract for property or services. *Id.* Therefore, the Army argued, the contract was not subject to CICA, and because CICA was the source of the GAO's bid protest jurisdiction, the GAO had no authority to hear the protest. *Id.* The GAO stated that CICA conferred it with authority to review procurements or awards of contracts for property or services. *Id.* It found that the Army's procurement had a dual purpose, that is, to transfer ownership of the water and wastewater facilities and to contract for water and wastewater treatment services for 10 years. *Id.* The GAO concluded that it had jurisdiction under CICA to hear the protest because one of the main objectives of the procurement was to obtain water and wastewater services. *Id.* It would appear that whenever there is a dual purpose procurement or contract, if a statute conferring jurisdiction to hear protests or disputes is applicable to one or the other purpose, the GAO, courts and boards will find jurisdiction to consider the entire protest or dispute.

<sup>139</sup> Although representatives from the installation may participate in some aspects of the formation stage, much of the initial policy decisions, document formation, financial structure of the agreement and even the negotiations and selection of a developer are handled at the level of the Service Secretaries and the Major Commands. The financial instruments are usually Service or Major Command-level documents and generally controlled from that level for modification purposes. Telephone Interview with Gordon Tanner, *supra* note 90. The Lackland AFB project had a significant amount of involvement from the Air Staff, as it was the first MHPI project. Telephone Interview with Gregory Petkoff, Attorney, SAF/GCQ (Feb. 1, 2001) (notes on file with author). The Elmendorf AFB project has been handled by



The installation is then responsible for ensuring developer performance over the term of the agreement, typically fifty years. The installation inspects construction/renovation, and is expected to enforce the agreement's requirements for long-term operation and maintenance. A number of issues may arise in performance as a result of actions taken, or not taken, in the formation phase.

### A. Installation Control Issues

The majority of MHPI projects either in progress, or in the planning stages, will be located on military installations.<sup>140</sup> The developer will own, operate and maintain the houses, and lease the underlying land from the agency for a term of fifty years.<sup>141</sup> Unlike housing owned and operated by the Government, occupancy of MHPI units is not initially restricted to active-duty military members.<sup>142</sup> Occupancy rates may drop such that civilians will

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attorneys, contracting personnel and hired consultants at the Pacific Air Forces, Elmendorf's Major Command. Telephone Interview with Captain (Capt) Jennifer Bell-Towne, Chief, Contract Law, Elmendorf AFB, Alaska (Dec. 5, 2000) (notes on file with author). Contract and solicitation and award on the Fort Carson project was done by the Corps of Engineers and then transferred to the installation for administration. E-mail from Maj Dru Brenner-Beck, *supra* note 83.

<sup>140</sup> Currently, the Dyess AFB project and the Navy projects at Kingsville, Texas and Everett, Washington, are located off the military installation.

<sup>141</sup> See Lackland solicitation, *supra* note 60, at sec. 1.0; Elmendorf solicitation, *supra* note 84, at sec. 1.3.2; Telephone Interview with Maj Dru Brenner-Beck, *supra* note 64.

<sup>142</sup> 2000 GAO REPORT, *supra* note 5. Each agreement contains a priority list of unit occupancy, with the highest priority given to active-duty military members referred to the developer by the installation housing office. In most agreements, if occupancy drops below a certain percentage for a set period of time, the developer is allowed to rent the units to non-active-duty members. For example, in the Air Force solicitations for Lackland and Elmendorf, military families referred through the installation's housing office are given priority for the developer's units. If the occupancy rate drops below 95% for more than three months, vacant units are available to other tenants in order of the priority set forth in the solicitation. See Lackland solicitation, *supra* note 60, at sec. 3.1.9; Elmendorf solicitation, *supra* note 84, at sec. 3.3.4.6. Fort Carson's contract also has a priority list under which civilians could occupy the housing units. Telephone Interview with Maj Dru Brenner-Beck, *supra* note 64. The agreements will generally include a list of occupant priorities that include federal civil service employees, military retirees, military reservists, armed forces veterans, and members of the public. The Elmendorf list prioritizes in descending order of priority, beginning with active-duty Air Force members referred by the base housing office and continues with other active-duty Air Force members, other active-duty military members, federal civil service employees, military retirees, military Reserve and Guard, military veterans and the general public. Elmendorf solicitation, *supra* note 84, at amend. 2. Lackland is similar, beginning with military families referred by the base housing office and then to federal civil service employees, military retirees, Lackland AFB contractors, and the public. Lackland solicitation, *supra* note 60, at sec. 3.1.9. As a result of long waiting lists for housing at the installations, the services are doubtful occupancy rates will drop low enough that civilians will occupy the units. See Memorandum for Record, Lieutenant Colonel (Lt Col) Daniel K. Poling, Deputy Staff Judge Advocate, Fort Carson, Colorado, para. 7(b) (Apr. 5, 2000) (on file with author);

occupy the MHPI housing units, raising a number of questions regarding their status on the installation, and the ability of the commander to exercise control over the installation. This section will address two specific concerns regarding civilian tenants in MHPI housing. First, does the installation commander have authority to authorize searches of civilian-occupied homes on the installation for evidence of criminal misconduct? Second, if civilian tenants engage in misconduct on the installation, what are a commander's boundaries in taking action involving or impacting those civilians?

### *1. Search Authorization*

The question of whether the installation commander may legally authorize searches of civilian-occupied privatized housing on the installation is a concern for the Services because it goes to the very heart of a commander's traditional responsibility for and authority over the installation. Presently, the Army and the Air Force have MHPI housing projects occupied by military families. Although no civilians currently occupy installation housing, and long active-duty waiting lists for housing indicate it may not happen for some time, a split in the Services on this issue indicates a need for discussion and eventually formal guidance.<sup>143</sup>

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Telephone Interview with Maurice Deaver, Chief, Contract Law, Lackland AFB, Texas (Feb. 9, 2001) (notes on file with author).

However, none of the projects completed to date require military families to accept the MHPI housing. See Elmendorf solicitation, *supra* note 84, at sec. 3.3.4; Lackland solicitation, *supra* note 60, at 1.0(c); Fort Hood RFQ, *supra* note 91, at pt. I, sec. 3.2. They are free to accept the houses, seek private sector houses, or remain on the waiting list for Government-owned housing on the installation. Depending on how MHPI houses compare to houses in the local community in terms of size, amenities, upkeep and costs, it is conceivable that military families may choose not to occupy MHPI houses. 1998 GAO REPORT, *supra* note 6, at ch. 2:3.3. In addition, if DoD is successful in its program to close the gap between BAH and actual housing costs, more military families may choose to live off base rather than in MHPI housing. A 1999 Rand study found that the strong demand for military housing is primarily due to the benefit gap. *An Evaluation of Housing Choices Among Military Families*, Study MR-1020-OSD (Rand, 1999), <http://www.rand.org/publications/MR/MR1020/index.html> (last visited Feb. 5, 2001). (The benefit gap is the financial difference between living in a Government-owned house where rent and utilities are at no cost to the member, versus the out of pocket expenses involved with living in the civilian community. *Id.* This is the result of the difference between housing allowances and actual costs. *Id.*) The study found that very few military families would prefer to live in Government-owned housing on base if this benefit gap was eliminated. *Id.*

<sup>143</sup> The Fort Carson legal office concluded that the installation commander has authority to authorize searches of civilian-occupied privatized housing on the installation. Memorandum for Record, Lt Col Daniel K. Poling, *supra* note 142. In contrast, at least one legal opinion from the Air Force concluded that once the property is conveyed to the developer, the installation commander may no longer authorize searches of MHPI housing, but may continue to authorize searches of individuals subject to the UCMJ. Overview of Legal Authorities and Issues Associated with Housing Privatization, Lt Col Steve Hatfield, AFMC LO/JAV, Wright

The critical question is whether a search conducted pursuant to a commander's search authorization is a violation of a civilian's Fourth Amendment rights.<sup>144</sup> Installation commanders have the inherent authority and obligation to ensure good order and discipline on the military installation. It has long been recognized that military commanders have the power to search military persons and property within their jurisdiction.<sup>145</sup> The Military Rules of Evidence recognize the power of the commander to authorize searches of military property and "property situated on or in a military installation or any other location under military control...."<sup>146</sup>

In MHPI housing, the issue is whether houses owned by a private developer on Government land leased to the private developer, but physically located within the confines of the installation, are property under military control. If a commander-authorized search of civilian-occupied privatized housing was challenged, the outcome of the case might depend more on the language in the agreements than traditional notions of military authority.

No court has yet addressed the search issues presented by MHPI housing projects on the installation. However, the U.S. District Court for the Eastern District of Virginia has upheld search of a civilian employee's apartment on the installation.<sup>147</sup> The facts of the case do not indicate whether the Government owned the housing, but because the installation was in Cuba, the court held it was clear that the military had control over all the property within the confines of the installation.<sup>148</sup> In another case, a military commander's search of a civilian-occupied home that was part of a military compound overseas was held to violate the civilian's Fourth Amendment rights.<sup>149</sup> However, in that case, the court's analysis focused on the unreasonableness of the search and lack of probable cause rather than the authority of the military commander to direct the search.<sup>150</sup>

Courts have upheld a commander's ability to search off-base apartments leased by the military and occupied by military personnel.<sup>151</sup> In those cases, the courts focused on lease language specifically stating that the apartments were under the control of the military.<sup>152</sup>

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Patterson AFB, Ohio (undated), <https://www.afmc-mil.wpafb.af.mil/HQ-AFMC/JA/lo/lojav/privatization/housing/index3.htm>.

<sup>144</sup> *Saylor v. United States*, 374 F.2d 894, 898 (Ct. Cl. 1967).

<sup>145</sup> *United States v. Walsh*, 21 C.M.R. 876, 883 (1956).

<sup>146</sup> MANUAL FOR COURTS-MARTIAL [hereinafter MCM], UNITED STATES, MIL. R. EVID. 315(b) (1998).

<sup>147</sup> *United States v. Rogers*, 388 F. Supp. 298 (E.D. Va. 1975).

<sup>148</sup> *Id.* at 301.

<sup>149</sup> *Saylor*, 374 F.2d 894.

<sup>150</sup> *Id.*

<sup>151</sup> See *United States v. Reppert*, 76 F. Supp. 2d 185 (D. Conn. 1999); *Donnelly v. United States*, 525 F. Supp. 1230 (E.D. Va. 1981).

<sup>152</sup> In one case, the lease provided that the apartments were under the control of the Navy, even to the exclusion of the owner. *Donnelly*, 525 F. Supp. at 1232.

Notably, there is a judicial reference relating to privatized housing projects (known as “Wherry” or “Capehart” housing) from the 1950s. The Court of Military Review noted that the Judge Advocate General of the Air Force had “expressed doubt whether a base commander could lawfully order a search of a Wherry Housing unit situated on the base occupied by a military person and recommended that in such a case, the search should be conducted in accordance with the authority granted by a lawful search warrant.”<sup>153</sup>

In the case of MHPI housing, the potential exists that civilians completely unaffiliated with the military may be occupying housing units on the installation. Although it may seem unlikely that this possibility will occur, it should be addressed with the developer before an agreement is signed. The Services can address it in a number of different ways.

First, the Service could anticipate the possibility prior to determining which installations will receive MHPI housing. The Air Force considers the severability of the MHPI housing project from the installation as a mandatory factor in selecting installations to receive MHPI housing projects.<sup>154</sup> If civilians begin occupying the units in increasing numbers, the Air Force may simply sever the project from the base, putting it outside the installation fences.<sup>155</sup>

Fort Carson has attempted to deal with the problem a second way, inserting a provision in the lease between the developer and the tenant stating that MHPI houses are in an area of exclusive federal jurisdiction and the premises are under military control.<sup>156</sup> The agreement between the developer

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<sup>153</sup> United States v. Walsh, 21 C.M.R. 876, 884 (1956) (citing Op JAGAF 88-11.2, 6 August 1952; Op JAGAF 88-11.2, 5 April 1955). Wherry and Capehart housing were privatized housing projects prevalent in the 1950s. Private businessmen constructed, operated and maintained these housing projects on or near military installations, and military families could rent the houses using their housing allowance. William C. Baldwin, *Wherry and Capehart: Army Family Housing Privatization Programs in the 1950s*, ENGINEER MAGAZINE, available at <http://www.wood.army.mil/ENGRMAG/PB5961/PB5962/pastview.htm> (last visited Jun. 28, 2000).

<sup>154</sup> Telephone Interview with Lieutenant Colonel (Lt Col) Brian Huizenga, AF/ILEIP (Feb. 2, 2001) (notes on file with author). See also Draft Air Force Housing Privatization Policy and Guidance Manual, *supra* note 17, at section 5.2.1.

<sup>155</sup> *Id.* It should be noted, however, that this contingency has not been listed in the solicitations, and if not set forth in the agreement itself, could constitute a breach of contract. Whereas the contractor bargained for houses on the installation, complete with the conveniences and reduced costs associated with that location, moving the fences could be viewed to change the bargain entirely. In most of these projects, the installation provides fire protection, law enforcement, and the security and convenience of the installation itself. Moving the housing project outside the gates may change the costs to the developer and the willingness and desire of military members to occupy the units.

<sup>156</sup> Fort Carson Tenant Lease, para. 13 (on file at the Fort Carson Legal and Housing Offices). One potentially complicating factor is that the tenant lease specifically states that the Army retains the ability to authorize and conduct inspections in all areas leased or owned by the developer on Fort Carson. *Id.* It does not, however, specifically reference searches for the purpose of investigating criminal activity rather than mere inspections of the premises. See *id.*

and the Government contains no such specific language, however, and the effect of inserting it into the tenant lease is questionable. The case law suggests that clear language in the agreement between the Government and the developer may be sufficient to extend the commander's authority to search property not owned by the Government.<sup>157</sup>

Ultimately, it is also clear that to have any chance of being upheld, searches of civilian occupied houses by military authorities must comply with the basic requirements of the Fourth Amendment.<sup>158</sup> This may require new training for commanders and military law enforcement personnel to enable them to effectively and correctly handle situations involving the civilian occupants of MHPI housing on the installation.

The fact of exclusive or concurrent jurisdiction is another factor to consider in determining the exercise of search authority in MHPI housing on the installation.<sup>159</sup> If civilians occupy housing units on the installation, installations may choose to convert the housing areas to areas of concurrent, rather than exclusive jurisdiction.<sup>160</sup> This permits local civilian law enforcement to handle problems, investigations, searches and seizures when civilians are involved. It would mitigate the potential uncertainty regarding a commander's search authority by allowing civilian law enforcement to deal with problem civilians. It may also alleviate the potential for *Bivens*<sup>161</sup> suits against military law enforcement officers.

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<sup>157</sup> See *supra* notes 147-153 and accompanying text.

<sup>158</sup> See *United States v. Rogers*, 388 F. Supp. 298 (E.D. Va. 1975); *Saylor v. United States*, 374 F.2d 894, 898 (Ct. Cl. 1967).

<sup>159</sup> In areas of exclusive federal jurisdiction, such as Fort Carson's housing project, individuals committing crimes in housing will be prosecuted in federal, rather than state court. Additionally, only federal law enforcement authorities have jurisdiction in areas of exclusive federal jurisdiction. In areas of concurrent jurisdiction, however, both the state and the federal Government have law enforcement and prosecutorial power. See U.S. DEP'T OF AIR FORCE, HANDBOOK (AFHB) 31-218, LAW ENFORCEMENT MISSIONS AND PROCEDURES, para 3.3 (1 Sept. 1997).

<sup>160</sup> "Notwithstanding any other provision of law, the Secretary concerned may, whenever he considers it desirable, relinquish to a State, or to a Commonwealth, territory, or possession of the United States, all or part of the legislative jurisdiction of the United States over lands or interests under his control in that State, Commonwealth, territory, or possession. Relinquishment of legislative jurisdiction under this section may be accomplished (1) by filing with the Governor (or, if none exists, with the chief executive officer) of the State, Commonwealth, territory, or possession concerned a notice of relinquishment to take effect upon acceptance thereof, or (2) as the laws of the State, Commonwealth, territory, or possession may otherwise provide." 10 U.S.C.A. § 2683(a) (West 2001). The complicating factor under this alternative is that the state must consent and accept the change in jurisdiction for something other than exclusive jurisdiction. If the houses are not providing any income to the state in terms of property taxes and the like, the state may be reluctant to accept a change in jurisdiction that will increase the burden on its services without providing income to offset the increased demand.

<sup>161</sup> *Bivens v. Six Unknown Named Agents of Federal Bureau of Narcotics*, 403 U.S. 388 (1971). In *Bivens*, the Supreme Court held that a federal law enforcement agent may be held personally liable if he violates an individual's Fourth Amendment rights. *Id.* The agent can be

## 2. Barment

Another issue related to a commander's authority to control activities on the installation is the ability to bar individuals from entering the installation. If a civilian rents an MHPI house and engages in misconduct on the installation, can the installation commander bar the individual from the installation?

The power of an installation commander to exclude individuals, including civilians, from the installation has traditional, historical and statutory bases.<sup>162</sup> The Services view this authority as necessary for the installation commander to protect personnel and property and to maintain good order and discipline on the installation.<sup>163</sup>

Courts have upheld the authority of installation commanders to bar civilians from the military installation in numerous cases.<sup>164</sup> However, the power to exclude civilians from military installations is not without limitation.<sup>165</sup> The courts look to the area where the civilian was ordered not to enter to determine if it was an area sufficiently under the military commander's control. The courts also balance the interests of the civilian in entering the installation against the military's interest in preventing entry.

Commanders can only exercise barment authority in areas where the United States has absolute ownership, or an exclusive right to the possession of

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held personally liable even if he was acting within the scope of his employment and under color of his authority. *Id.* *Bivens* has application to MHPI housing in that military law enforcement officials may be subject to personal liability if they violate the Fourth Amendment rights of civilian occupants. If military police conduct a search of a civilian-occupied MHPI house pursuant to the installation commander's search authorization that is later found to be a violation of the civilian's constitutional rights, the individual law enforcement officers and the commander could be held personally liable for monetary damages. This is a particularly significant concern because of the absence of case law indicating the boundaries of the commander's authority to authorize searches of civilian occupied privatized housing on the installation. As a result, it may be prudent for commanders to exercise restraint where civilians are concerned and allow federal magistrates or civilian judges to authorize searches, depending on jurisdiction in the MHPI housing areas.

<sup>162</sup> *Cafeteria & Restaurant Workers Union v. McElroy*, 367 U.S. 886 (1961) (stating a military commander's ability to exclude persons from the installation at will was recognized as early as 1837 in an Attorney General's opinion). The commander's authority also arises from 18 U.S.C. § 1382, which sets forth criminal penalties for entering military installations after being previously ordered not to reenter by the installation commander. *See also* *United States v. Jelinski*, 411 F.2d 476 (5th Cir. 1969).

<sup>163</sup> Barment, Op JAGAF, Air Force, No. 188 (12 Dec 1996).

<sup>164</sup> *Holdridge v. United States*, 282 F.2d 302 (8th Cir. 1960); *Cafeteria & Restaurant Workers Union v. McElroy*, 367 U.S. 886 (1961); *United States v. Packard*, 236 F. Supp. 585 (N.D. Ca. 1964).

<sup>165</sup> *United States v. Watson*, 80 F. Supp. 649 (E.D. Va. 1948); *United States v. Jelinski*, 411 F.2d 476 (5th Cir. 1969).

the area where the civilian is barred from entering.<sup>166</sup> Criminal jurisdiction over the area alone is insufficient.<sup>167</sup> What does and does not constitute absolute ownership or exclusive right to possession is a factual determination.

In *United States v. Watson*, the installation commander for the Marine barracks at Quantico, Virginia, barred a civilian from using a road that linked Quantico, a military reservation, to the outside community.<sup>168</sup> The road was on land the United States had acquired in fee.<sup>169</sup> However, the road had traditionally been used as a public thoroughfare to provide ingress and egress to Quantico.<sup>170</sup> The Court found that the United States had ownership of and criminal jurisdiction over the road, but it did not have exclusive right to possession because it was not the exclusive user of the road.<sup>171</sup> Therefore, the conviction of the civilian under 18 U.S.C. § 1382 was overturned.<sup>172</sup> However, in another case, a different court found ownership and exclusive right of possession in a housing area that was owned by the United States and part of the military reservation, but was outside the gates of the installation.<sup>173</sup>

In the case of MHPI housing, it is unclear whether the installation commander has the authority to bar civilians residing in those houses from the installation. The MHPI houses located on the installation sit on Government-owned land, but that land is leased to the developer.<sup>174</sup> Further, the houses themselves are conveyed in fee to the developer, and are therefore owned, operated and maintained by the developer.<sup>175</sup> Although law enforcement typically patrols these housing areas, the developer shares possession with the Government, perhaps exercising a greater presence and control in these areas than the Government.<sup>176</sup> It is unlikely that in such circumstances the United

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<sup>166</sup> *United States v. Watson*, 80 F. Supp. 649 (E.D. Va. 1948); *United States v. Packard*, 236 F. Supp. 585 (N.D. Ca. 1964); *Holdridge v. United States*, 282 F. 2d 302 (8th Cir. 1960).

<sup>167</sup> *Watson*, 80 F. Supp. at 651.

<sup>168</sup> *Id.*

<sup>169</sup> *Id.* at 650.

<sup>170</sup> *Id.* at 651.

<sup>171</sup> *Id.*

<sup>172</sup> *Id.*

<sup>173</sup> *Packard*, 236 F. Supp. 585. In this case, a salesman violated the commander's order not to re-enter a military housing area located just outside the gates of the installation. *Id.* at 586. The court found that signs indicating United States ownership of the area, coupled with regular military patrols of the area, were sufficient to constitute exclusive possession so that the salesman's conviction under 18 U.S.C. § 1382 was proper. *Id.*

<sup>174</sup> The Elmendorf AFB project, for example, included conveyance of 504 housing units in three housing areas on the installation, with an accompanying lease of 128 acres of land on which the houses are situated. Elmendorf solicitation, *supra* note 84, at sec. 1.3. The Lackland project leased 30 acres of land to the developer, upon which 272 housing units were situated that were conveyed to the developer. Lackland solicitation, *supra* note 60, at sec. 1.0(b).

<sup>175</sup> See Lackland solicitation, *supra* note 60, at sec. 1.0; Elmendorf solicitation, *supra* note 84, at sec. 1.3.2; Fort Hood RFQ, *supra* note 91, at pt. I, sec. 1.1.

<sup>176</sup> The Lackland solicitation explicitly states that military security forces personnel will provide law enforcement for the MHPI housing development. Lackland solicitation, *supra*

States has the requisite exclusive right to possession of these housing units and housing areas to enable the commander to bar civilian occupants from that portion of the installation. Clearly, civilians could be barred from any areas on the installation other than those leased to the developer in an MHPI project, but barment from the MHPI housing area will likely exceed the installation commander's authority in that area.<sup>177</sup>

Indeed, barment of civilians from MHPI installation housing has potential constitutional implications. Courts have balanced the interests of the civilian against those of the military in determining the extent of the military commander's authority to bar civilians from the installation.<sup>178</sup> Constitutional implications may affect a commander's ability to unilaterally bar an individual from the installation if the civilian's interest in entering the installation is so great that it brings with it the Fourteenth Amendment's protection of due process.<sup>179</sup>

Barring a civilian occupant of MHPI housing from the installation would result in a *de facto* eviction from the housing unit.<sup>180</sup> The Supreme Court has stated that the Constitution does not require a trial-type hearing in every conceivable case of Government impairment of a private interest.<sup>181</sup> However, the procedures due process may require will depend on the nature of

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note 60, at sec. 3.1.4. Similarly, the Operating Agreement in the Elmendorf solicitation provides that Elmendorf Security Forces personnel will provide law enforcement and security assistance in MHPI housing area. Elmendorf solicitation, *supra* note 84, at app. I, exhibit E, para. 5(c). It also specifically states that Elmendorf will provide fire protection services. *Id.* at app. I, exhibit E, para. 6. The Fort Carson tenant lease states that the Landlord, United States Government, Army, and Fort Carson military authorities all have the right to enter the premises to make repairs or to inspect. Fort Carson Tenant Lease, para. 13, *supra* note 156.

<sup>177</sup> An Air Force Judge Advocate General's Opinion concluded that in the case of non-DoD personnel residing in on-base family housing privatization projects, the installation commander's authority under 18 U.S.C. § 1382 to bar those civilians from the installation is unaffected. OpJAGAF 1996/188, *supra* note 163. The opinion provided no discussion of how the structure of the MHPI program might affect a court's determination of Government ownership or exclusive possession of such housing areas on the installation. *Id.* Additionally, it contained only brief mention of the interests of the civilian residents in remaining in their rented home, another factor that may impact the ability or methodology of an installation commander seeking to bar a civilian resident from the installation. *Id.* See *Cafeteria & Restaurant Workers Union v. McElroy*, 367 U.S. 886, 895 (1961).

<sup>178</sup> *Id.*; *United States v. Jelinski*, 411 F.2d 476, 478 (5th Cir. 1969).

<sup>179</sup> *Cafeteria & Restaurant Workers Union*, 367 U.S. at 895.

<sup>180</sup> An "actual eviction" is defined as "[a]n actual expulsion of the tenant out of all or some part of the demised premises." BLACK'S LAW DICTIONARY 35 (6th ed. 1990). "Eviction" is defined as "the act of depriving a person of the possession of land or rental property which he has held or leased." *Id.* at 555. If a civilian renting a home on the installation cannot access the installation, then he can no longer live in the house. This is tantamount to an eviction. In addition, the Supreme Court held that depriving a person of access to his mobile home in the absence of a lawful eviction order was an unlawful seizure of property in violation of the Fourth Amendment. *Soldol v. Cook County*, 506 U.S. 53 (1992).

<sup>181</sup> *Cafeteria & Restaurant Workers Union*, 367 U.S. at 895.



the Government function involved and the private interest affected.<sup>182</sup> Where a private individual's interest can be characterized as a "mere privilege subject to the Executive's plenary power, it has traditionally been held that notice and hearing are not constitutionally required."<sup>183</sup>

An individual's ability to enter a military installation is generally viewed by the courts as a privilege, not a right, and therefore not subject to due process requirements.<sup>184</sup> The Government's interest in barring individuals from the installation is in managing the internal operation of the military installation.<sup>185</sup> To outweigh this interest, the civilian's interest in entering the installation has to rise to one that is constitutionally protected, such as a liberty or property interest.<sup>186</sup> Whether access to a home currently rented by the civilian in the MHPI housing area rises to the level of a liberty or property interest that would outweigh the Government's interest is uncertain.

The courts have held that a civilian's interest in employment with a Government contractor on the installation does not rise to a level requiring barment due process.<sup>187</sup> Similarly, the interests of a military dependent in entering the installation to use the recreational facilities and the base exchange is a privilege and does not amount to a constitutionally protected interest requiring due process.<sup>188</sup>

In contrast, outside of the context of the military installation, the courts have held that the expectation of individuals to utility services rises to the level of a property right such that the Fourteenth Amendment requires due process before deprivation of that right.<sup>189</sup> If receiving utility services rises to the level of a constitutionally protected property interest, it is difficult to see how a court could find otherwise regarding access to a home. If a civilian tenant's interest in access to the rented home rises to the level of a constitutionally protected property interest, it is likely an installation commander could not bar the person without, at a minimum, notice and an opportunity to be heard.

As previously stated, barring a civilian from the installation would be the equivalent of an eviction, raising a number of contractual issues regarding the Government's right to preclude civilian tenants from the housing area. The Government would essentially be interfering in a contractual relationship

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<sup>182</sup> *Id.*

<sup>183</sup> *Id.*

<sup>184</sup> *Id.* at 891.

<sup>185</sup> *Id.* at 896.

<sup>186</sup> *Id.* at 894.

<sup>187</sup> *Id.* at 896. The Court held that Government employment can be revoked at will, absent legislation to the contrary. It found that the barment did not deprive the civilian of the ability to work, only the opportunity to work at the one installation. She was free to obtain employment anywhere else.

<sup>188</sup> *United States v. Jelinski*, 411 F.2d 476 (5th Cir. 1969).

<sup>189</sup> *Memphis Light, Gas & Water Div. v. Croft*, 436 U.S. 1 (1978). Water service to residences has been found to be a property right requiring due process before denial of service. *Ransom v. Marrazzo*, 848 F.3d 398 (3rd Cir. 1988).

between the developer and a civilian tenant.<sup>190</sup> It would disrupt the developer's income stream, and may constitute a Government breach of its contract with the developer. These issues should be considered before executing the agreement between the Government and the developer.

The agreement should be drafted to preclude the problems discussed above. The agreement between the developer and the Government should expressly set forth that the premises remain under military control. The agreement should further recognize the ability of the installation commander to bar civilians engaged in misconduct on the installation.

The Air Force has included a statement in the Operating Agreement that is part of the lease with the developer stating that the commander's rights are not impaired and that the commander has the right to bar anyone from the installation.<sup>191</sup> This wording may alleviate concerns about breach of contract, but it will not impact the problems of exclusive control or constitutional issues.

In order to address these latter issues, the agreement should set forth the circumstances that would be grounds for a barment action and require that notice of the installation commander's decision to bar a civilian tenant be provided to the developer, who must then initiate eviction action against the tenant.<sup>192</sup> In the meantime, the installation commander should tailor a barment order for the civilian tenant excluding him from the installation except for the purpose of accessing the MHPI housing unit. In this way the installation commander can exercise authority over areas clearly within military control, and continue to protect Government personnel and property by keeping the problem civilian out of most of the installation. It also avoids the potential constitutional issues because the civilian would still be able to access the

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<sup>190</sup> Pursuant to the MHPI agreements, service members enter into lease agreements with the developer, pay rent directly to the developer, and the Government is not a party to the tenant lease agreement. *See* Fort Carson Tenant Lease, *supra* note 156.

<sup>191</sup> Air Force Generic RFP, Operating Agreement to the Lease, Condition 28, <http://www.afcee.brooks.af.mil/dc/dcp/news/download/genericrpf.pdf>. This provision specifically states "[n]othing in this Lease shall be construed to diminish, limit or restrict any right, prerogative, or authority of the commander as established in law, regulation, military custom or elsewhere." *Id.* It further provides that the "Commander has the right at all times to order the permanent removal and barment of anyone from the installation, including but not limited to tenants, if he or she believes, in his or her sole discretion, that the continued presence on the installation of that person represents a threat to the security or mission of the installation, poses a threat to the health, welfare, safety or security of persons occupying the installation or compromises good order and/or discipline on the installation." *Id.*

<sup>192</sup> These grounds should then be inserted in the lease between the developer and the civilian tenants as grounds for eviction. The Elmendorf solicitation contains a debarment provision that is helpful, but does not go far enough to require the developer to initiate eviction action. It states that the "Commander has the right at all times to order the permanent removal and debarment of anyone from Elmendorf AFB, including but not limited to tenants, if he or she believes in his or her sole discretion that the continued presence of that person represents a threat to the security or mission of Elmendorf AFB, poses a threat to the health, welfare, safety or security of persons occupying Elmendorf AFB or compromises good order and/or discipline on Elmendorf AFB." Elmendorf solicitation, *supra* note 84, at app. I, para. 29.2.

home, thereby avoiding allegations that the Government interfered with a constitutionally protected property right. More importantly, it provides a contractual basis for the installation commander to ensure the eviction of the tenant in a manner consistent with law and the contract.

## **B. Fiscal Law Issues**

A unique challenge, and perhaps the most difficult one for attorneys at MHPI installations, is educating commanders, service members, and even the developers that the rules that used to apply to “Government housing” do not necessarily apply to MHPI housing.<sup>193</sup> This is particularly true in the fiscal law arena.

Congress annually enacts public laws appropriating funds for the support of traditional military family housing. When the Government owns the housing, the Government is responsible for upkeep of common grounds, maintenance of the houses, landscaping, playgrounds, sports areas, and pest control, all of which are provided through the expenditure of appropriated funds (APFs).

There are a number of specific types of APFs used to develop and support traditional military family housing, and the purpose of an expenditure controls whether a particular type of APF is properly available for obligation.<sup>194</sup> Generally speaking, Operations and Maintenance (O&M) funds are available for the daily expenses of operating a traditional military family housing area.

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<sup>193</sup> See Telephone Interview with Capt Craig Crimmons, *supra* note 68. See also Telephone Interview with Maj Dru Brenner-Beck, *supra* note 64.

<sup>194</sup> The Military Construction Appropriations Act contains separate appropriations for each of the Services for family housing operations and maintenance and for family housing construction. *E.g.*, Military Construction Appropriations Act for Fiscal Year 2002, Pub. L. No. 107-64, 114 Stat. 474 (Nov. 2001) (provides specific appropriations for family housing operation and maintenance and construction); *cf.* the Department of Defense Appropriations Act for Fiscal Year 2001, Pub. L. No. 106-259, 114 Stat. 656, § 8098 (Aug. 2000) (explicitly prohibiting expenditure of funds appropriated by the act for the purpose of performing repairs or maintenance to military family housing). In addition to the annual appropriations acts, the annual DoD authorization acts set forth enumerable and often program-specific conditions and authorizations that specify the purposes for which the individual appropriations may be expended. See National Defense Authorization Act for Fiscal Year 2002, *supra*, note 44. Any resident relations programs the installation may offer are typically funded with APFs. For example, most installations sponsor a yard-of-the-month program with the winner receiving a sign to display in their yard, sometimes coupled with a small prize for winning a specified number of times. At Fort Carson, if someone won yard-of-the-month five times, they received a free cleaning of their quarters upon vacating them. Memorandum from Maj Dru Brenner-Beck, Chief, Administrative and Civil Law, Fort Carson, to Harrison Cole, Contracting Officer, Fort Carson, subject: Use of Appropriated Funds (APFs) for Housing Purposes and the Capital Venture Initiative (CVI) Contract (19 Jul. 2000) (on file with author) [hereinafter Brenner-Beck APF Memo]. See also U.S. DEP’T OF AIR FORCE, HANDBOOK (AFHB) 32-6009, CIVIL ENGINEERING (1 June 1996).

Once the Government conveys the houses to the private developer, the ability of the Government to use APFs for anything related to the housing project is severely limited.<sup>195</sup> This section will examine fiscal law issues that may be encountered by installation attorneys, including whether APFs can be used for the following purposes once the award is made: moves of Government personnel into MHPI houses, resident relations programs, facilities improvements and repairs, and services such as pest control and landscaping.

### *1. Personnel Moves*

The first fiscal law issue likely to arise in the MHPI context is who pays to move personnel into MHPI housing from their current residences. Generally, absent a Government direction to move, service members who choose to move from one house to another house, off or on the installation, must pay for the move themselves.<sup>196</sup> However, the MHPI program and applicable regulations allow the Government to use APFs to move service members into MHPI houses in most circumstances.<sup>197</sup>

There are four primary circumstances under which moves into MHPI housing might occur. First, intra-installation moves may be required to move families from one MHPI house to another as a result of the contractual obligations of the Government under MHPI agreements to vacate houses slated for rehabilitation or demolition. Second, families in houses that will be conveyed to the developer under MHPI agreements may not wish to continue living in those houses, preferring to live in Government-owned quarters or commercial housing off the installation. Third, individuals living off the

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<sup>195</sup> Appropriated funds are limited in their use by the Purpose Statute. 31 U.S.C.A. § 1301(a) (West 2001). The Purpose Statute limits the use of appropriated funds to those objects for which the appropriation was made. *Id.*

<sup>196</sup> 1 Joint Fed. Travel Reg. ¶ U5355 (1 Jan. 2001).

<sup>197</sup> The Army and the Air Force have made similar conclusions. See Memorandum from Lieutenant Colonel (Lt Col) Kathryn Stone, Chief, General Law Branch, Administrative Law Division to Lana Swearingen, Office of the Asst. Chief of Staff for Installation Management, subject: Payment of Local Moves UP Military Housing Privatization Initiative (28 Jan. 1998) (on file with author) [hereinafter Stone Memo]; Memorandum from Jackson A. Hauslein, Jr., Associate General Counsel, SAF/GCA to Col. Smith, AF/ILEH, subject: Drayage and Storage of Household Goods in Connection with Moves into Privatized Housing (9 Jun. 1999) (on file with author) [hereinafter Hauslein Memo]. The Army has also concluded that APFs may be used to fund telephone and cable TV disconnect and reconnect costs in local moves between Government housing units due to MHPI construction or maintenance and repair projects. Stone Memo, *supra* (citing U.S. DEP'T OF ARMY, REG. (AR) 210-50, HOUSING MANAGEMENT, paras. 2-8, 2-9 (26 Feb 1999)). Additionally, the Air Force concluded that while certain personnel moves may be funded with APFs, there was no authority to fund storage of household goods in connection with MHPI project moves. Hauslein Memo, *supra* (finding that JFTR authorization for Government funded storage only applies in very limited circumstances).

installation, and formerly on waiting lists for Government housing, may wish to rent MHPI housing and want to be moved into MHPI housing at Government expense. Finally, individuals living in Government-owned housing or newly conveyed MHPI housing may request to move into newly constructed or renovated MHPI housing.

The MHPI legislation allows MHPI housing to be considered “Government quarters” and authorizes the Service Secretaries to assign members to MHPI housing.<sup>198</sup> The Joint Federal Travel Regulation (JFTR) authorizes the Government to fund local moves when moving to or from Government quarters.<sup>199</sup> Recent changes to the JFTR specifically address assignment to privatized housing.<sup>200</sup> With regard to intra-installation moves, the Government may be contractually obligated to vacate houses conveyed to the contractor that are designated for rehabilitation or demolition.<sup>201</sup> In some cases units may be unfit for occupancy.<sup>202</sup> The Government may pay for local moves when the member is directed by competent authority to vacate quarters because they are unfit or to meet some other unusual operational requirement.<sup>203</sup> Regardless of the condition of the units, the contractual requirement to vacate would constitute an unusual operational requirement. Thus, the Government may use APFs to move occupants from houses requiring renovation or demolition into other housing on the installation, whether MHPI or Government-owned.<sup>204</sup> Similarly, service members may be moved into MHPI housing based on reassignment by the Service after conditions in the units are rectified or once they become available for

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<sup>198</sup> Specifically, the statute provides that MHPI housing “shall be considered as quarters of the United States....” 10 U.S.C. § 2882(b)(1). It should be noted that although the authority exists to assign members into MHPI housing, the current projects have not taken that approach. Service members are being given the choice to move into MHPI houses or to choose other housing, either on or off the installation. See Elmendorf solicitation, *supra* note 84, at sec. 3.3.4 (the Government will not guarantee occupancy of the units and freedom of housing choice for members shall be preserved); Fort Hood RFQ, *supra* note 91, at pt. I, sec. 3.2 (Army does not intend to use mandatory housing assignments).

<sup>199</sup> 1 Joint Fed. Travel Reg. ¶ U5355(A)(2) (1 Mar. 2001), available at <http://www.dtic.mil/perdiem/jftr.html>.

<sup>200</sup> *Id.* at ¶ U5355(C)(1)(d).

<sup>201</sup> For example, the Lackland project required the demolition of 272 units on a 30-acre site and the construction of new housing units on a 66-acre unimproved site. Lackland solicitation, *supra* note 60, at sec. 3.1.2. The agreement specifically required new construction on the 66-acre site begin first so that the 272 units on the 33-acre site could be vacated into the new units. *Id.* This required the Government to move personnel in the units set for rehabilitation into the newly constructed units so the Government could give the developer possession of that 30 acre improved site. *Id.*

<sup>202</sup> The Elmendorf project contained a number of units it deemed uninhabitable and had identified for demolition as part of the MHPI solicitation. Elmendorf solicitation, *supra* note 84, at sec. 2.4.2.

<sup>203</sup> 1 Joint Fed. Travel Reg. ¶¶ U5355(C)(1)(b), U5355(C)(2).

<sup>204</sup> *Id.* at ¶ U5355(C).

occupancy following construction.<sup>205</sup> Accordingly, there is authority for Government funded moves of personnel dislocated by MHPI repairs or demolition to be moved to other quarters during repair/construction and then back into newly repaired or constructed MHPI houses.

Service members currently living in Government-owned housing set for conveyance to the developer under an MHPI agreement may not wish to continue living there. Similar to the above analysis, if the houses are unfit or set for major rehabilitation, then the JFTR allows the Government to move their occupants to other quarters at Government expense upon the direction of competent authority.<sup>206</sup>

It is more difficult to justify using APFs in the third type of personnel move where individuals living off the installation in civilian housing want to move into MHPI housing.<sup>207</sup> The JFTR allows the Government to pay for personnel moves “directed by competent authority on the basis of a Service requirement such as...assignment to privatized housing.”<sup>208</sup> The problem with using this as authority to fund “volunteer” moves is that the Services have specifically declined to “direct” service members into MHPI quarters, allowing them instead to choose whether to occupy the quarters.<sup>209</sup> Thus, in addition to lack of direction, it would appear that there is also a lack of any service requirement given that such moves are based on members’ personal preference or convenience. Use of APFs to fund such moves is prohibited.<sup>210</sup>

The moves described above are similar to the fourth type of personnel move possible in the MHPI context. These include requests by service members to move from Government-owned quarters, or older (newly conveyed) MHPI houses on the installation, into newly constructed or rehabilitated MHPI units. Absent some health or safety concern regarding the habitability of the member’s current house, these are typically going to be

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<sup>205</sup> *Id.*

<sup>206</sup> *Id.*

<sup>207</sup> The Army and Air Force guidance does not specifically address this difficult issue. The Army opinion states that provided “local moves are directed by competent authority IAW the JFTR [Joint Federal Travel Regulation], paragraph U5355...there are no legal objections to the Government paying for such moves.” Stone Memo, *supra* note 197. Similarly, the Air Force memo indicates “...the Air Force may approve on a case-by-case basis government funding for a member’s move from local economy quarters to privatized housing when competent authority ...determines such a move is for the convenience of the Government.” Hauslein Memo, *supra* note 197.

<sup>208</sup> 1 Joint Fed. Travel Reg. ¶ U5355(C)(1)(d).

<sup>209</sup> See Elmendorf solicitation, *supra* note 84, at sec. 3.3.4 (the Government will not guarantee occupancy of the units and freedom of housing choice for members shall be preserved); Fort Hood RFQ, *supra* note 91, at pt. I, sec. 3.2 (Army does not intend to use mandatory housing assignments).

<sup>210</sup> See 1 Joint Fed. Travel Reg. ¶ U5355(C)(1).

convenience moves. As noted, the JFTR specifically prohibits Government funding of any moves purely for the convenience of the individual member.<sup>211</sup>

## 2. *Spending APFs on the MHPI Project*

Service members may be motivated to move to a MHPI housing area because of the “extras” it may offer. Most MHPI projects contemplate more than just a conveyance of houses to the developer. They envision an entire community, complete with playgrounds, sports facilities, and common gathering areas, all owned, operated, maintained, and managed by a private developer.<sup>212</sup> There may be instances when housing residents or installation authorities wish to make improvements or repairs not provided for in the original agreement. These situations present fiscal law problems.

For example, may the installation commander use APFs to purchase new equipment for the playgrounds? If the Government wants all MHPI housing on the installation to display the rank and name of the service member occupying the houses, may the commander use APFs to purchase nameplates or signs? Who funds purchases for the traditional resident relations programs? Many of the answers will be determined by the contractual agreement between the Government and the developer, and the applicable fiscal law principles.

The Fort Carson legal office has fielded a number of questions that implicate fiscal law issues. This section will use them as examples of the fiscal law issues that may arise at the installation level and will describe a method for analyzing them.

### *a. Signs*

Among the issues a new MHPI project may encounter is the proper use of APFs to fund traffic signs and resident name signs. Responsibility for various types of signs may be set forth in the contract between the Government and the developer.<sup>213</sup> To the extent that the MHPI agreement has exercised

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<sup>211</sup> *Id.* The Air Force has indicated it will be Air Force policy that the developer is responsible for funding local moves when moves are for the convenience of the developer. See Draft Air Force Housing Privatization Policy and Guidance Manual, *supra* note 17, at section 5.4.2.

<sup>212</sup> For example, the Elmendorf AFB solicitation sets forth “desired enhancements” including a self-help store, snow sled hill, outside ice skating area, and community recreation hall. Elmendorf solicitation, *supra* note 84, at sec. 3.2.2. The Fort Hood solicitation indicates its evaluation factors will include ancillary supporting facilities (child care centers, tot lots, community centers, dining facilities, schools, unit offices) and the extent to which they are incorporated into the overall development vision for the project. Fort Hood, RFQ, *supra* note 91, at pt. I, sec. 4.5.2. The MHPI legislation specifically allows ancillary facilities as part of MHPI projects, with some limitations. 10 U.S.C. § 2881.

<sup>213</sup> In Fort Carson’s case, responsibility for signs was set forth in the contract, with the developer assuming responsibility for particular types of signs. Brenner-Beck APF Memo, *supra* note 194.

MHPI statutory authority to confer responsibility for an expenditure to the contractor, then the Government cannot use APFs for the purchase because APFs may only be applied to the objects for which the underlying appropriation was made. Funds appropriated for maintenance of traditional military family housing cannot be applied to MHPI requirements without violating the purpose of the family housing O&M appropriation.<sup>214</sup> Such expenditures are the developer's responsibility under the MHPI agreement, and use of APFs constitutes a violation of the Purpose Statute.<sup>215</sup> It is no longer a necessary expense of the Government as the expense is assigned to the developer.

If the contract is silent regarding signs in the housing area, and the installation wants to use APFs to fund the purchase, then fiscal law principles should be examined to determine whether this use of funds is for a proper purpose.<sup>216</sup> For example, if the agreement is silent on responsibility for street signs, but the agreement indicates the developer is responsible not only for the renovation/construction of houses, but also for roads, utilities, area lighting and other infrastructure, then perhaps the developer's responsibility for street signs can be inferred.<sup>217</sup> If it can, then the use of APFs to purchase the signs and install them is improper. However, if the agreement is silent and no inferences can be drawn regarding responsibility, as might be the case with name signs for each unit, then the installation attorney must determine whether use of

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<sup>214</sup> The Purpose Statute. 31 U.S.C. A. § 1301(a)(West 2001). Congress does not detail each and every item the Government is authorized to use an appropriation for, but rather leaves the agencies some discretion in use of a particular appropriation. *See* HUD Gun Buyback Initiative, B-285066 (May 19, 2000). An expenditure is for a proper purpose if it meets a three-part test. Secretary of Interior, B-120676, 34 Comp. Gen. 195 (1954). First, the expenditure of an appropriation must be for a particular statutory purpose, that is, it is necessarily incident to accomplishing the purpose. *Id.* *See also*, Secretary of State, B150074, 42 Comp. Gen. 226, 228 (1962). Second, the expenditure must not be prohibited by law. Secretary of Interior, 34 Comp. Gen. 195. Third, the expenditure must not be otherwise provided for; it must not fall within the scope of some other appropriation. *Id.* To the extent that operation and maintenance and construction of traditional military family housing continues to be the purpose of O&M funds appropriated by the annual military construction appropriations acts, *see* note 194, *supra*, applying such funds for MHPI housing requirements would be for purposes other than those for which the O&M appropriations were made. *But see* 10 U.S.C. 2872a, *infra* at note 226, which allows the Government to use APFs to furnish utilities and enumerated services for MHPI housing on a reimbursable basis.

<sup>215</sup> 31 U.S.C. § 1301(a).

<sup>216</sup> For a discussion of the Purpose Statute and basic fiscal law principles, see The Army Judge Advocate General School, 62<sup>nd</sup> and 63<sup>rd</sup> Fiscal Law Course Deskbook, ch. 2 (2002) *available at* <https://www.jagcnet.army.mil/TJAGSA>.

<sup>217</sup> The Elmendorf solicitation does not appear to directly address responsibility for street signs, but it does transfer responsibility for essentially all of the housing area infrastructure and common areas, including covered bus stops, parks, sports areas, street lighting, and roads, to the developer. Elmendorf solicitation, *supra* note 84, at sec. 2.5. Although street signs may not be at issue in the Elmendorf project, it is illustrative of how responsibility can be inferred when an agreement is silent on a particular issue.



APFs to provide signs is for a proper purpose. For example, if the installation has a legitimate need to have the occupant's name and rank on the unit, such as for security reasons, then use of APFs may be appropriate.<sup>218</sup>

### *b. Resident Relations Programs*

Recognition for yard-of-the-month and other resident relations programs may be the most problematic in terms of fiscal law issues. Resolution of this issue will depend heavily on the terms of the individual MHPI agreements. Traditionally, installations used APFs to fund resident relations programs, such as yard-of-the-month signs, free move-out cleaning for five-time yard-of-the-month winners and housing "mayors," and free landscaping to "best village" winners.<sup>219</sup>

MHPI agreements may shift responsibility to develop, finance, and operate resident relations programs to the developer.<sup>220</sup> Although such agreements may not contain an itemized listing of what is included in the developer's program, the program as a whole is the contractual responsibility of the developer.<sup>221</sup> More specifically, the MHPI agreements do typically shift responsibility for landscaping in the MHPI housing area to the developer.<sup>222</sup>

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<sup>218</sup> In most MHPI agreements where the housing units are situated on the installation, the agreement will provide that the Government is responsible for providing security and fire protection services in some form and to some extent. See Lackland solicitation, *supra* note 60, at sec. 3.1.3, 3.1.4; Elmendorf solicitation, *supra* note 84, at app. I, exhibit E, paras. 5-6. The installation may argue that having the name and rank of the current occupant of each housing unit is essential for security reasons. In the event of a security or potential criminal matter, such as an emergency response to a domestic disturbance or a search, nameplates may be necessary to ensure security personnel have the right house to reduce the possibility of an error in the house number. The installation may also argue that, because it no longer controls who occupies the houses, it has a legitimate security interest in ensuring name identification is on the houses, particularly with the possibility of non-military tenants. In these cases, use of APFs to purchase letters and nameplates for individual housing units, even when owned by a private party, would likely be for a proper purpose.

<sup>219</sup> Fort Carson funded these programs pursuant to U.S. DEP'T OF ARMY, REG. (AR) 210-50, HOUSING MANAGEMENT, ch. 8 (26 Feb 1999). See Brenner-Beck APF Memo, *supra* note 194.

<sup>220</sup> It may be explicit or implicit in the agreement. Fort Carson's MHPI agreement specifically shifted responsibility for resident relations programs to the developer. Brenner-Beck APF Memo, *supra* note 205. The Air Force MHPI solicitations and agreements, although clearly turning over all responsibility for operating and maintaining the MHPI housing development, indicate no specific requirement for the developer to provide a resident relations program for tenants. See Lackland solicitation, *supra* note 60; Elmendorf solicitation, *supra* note 84.

<sup>221</sup> This is the case with the Fort Carson MHPI agreement. E-mail from Maj Dru Brenner-Beck, Chief, Administrative and Civil Law, Fort Carson, to Maj Holly Cook, Army Judge Advocate General School (Jan. 9, 2001, 3:18 PM) (on file with author).

<sup>222</sup> Fort Carson's agreement is typical in requiring the developer to assume responsibility for all operations and maintenance in the MHPI housing area, including what the Government previously provided as part of the installation's grounds maintenance contract. Telephone Interview with Maj Dru Brenner-Beck, *supra* note 64. The Lackland project also shifted the

Thus, as explained in the immediately preceding subsection, any expenses associated with yard-of-the-month signs or awards would no longer be a proper expenditure of APFs under the Purpose Statute.<sup>223</sup>

*c. Housing Upgrade, Maintenance, and Repair*

As previously explained, the installation can no longer expend APFs for anything that is the developer's contractual responsibility. Generally, MHPI agreements shift responsibility for services traditionally provided by the Government in Government-owned housing to the developer, including housing maintenance, grounds maintenance, landscaping and pest control.<sup>224</sup> The developer assumes responsibility for the construction and upkeep of playgrounds, common areas and sports areas, community centers or other ancillary facilities included in the MHPI agreement.<sup>225</sup> This means that if the residents want a new piece of equipment for the playground in the MHPI housing area, the installation cannot purchase it with APFs. Similarly, if the developer is responsible for pest control in the MHPI housing area, the Government cannot provide that service using a Government contractor or using the installation's pest control shop from civil engineering.<sup>226</sup> The same

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responsibility for landscaping to the developer, and that provision is typical in the Air Force agreements. See Lackland solicitation, *supra* note 60, at sec. 3.3.7.

<sup>223</sup> See *supra* note 214.

<sup>224</sup> Fort Carson is one example of a contract that shifted all responsibility for the housing area's operation and maintenance to the developer. Telephone Interview with Maj Dru Brenner-Beck, *supra* note 64. See also Elmendorf solicitation, *supra* note 84, at sec. 3.2. The Lackland and Elmendorf projects make it clear that operation and maintenance of the housing areas are the responsibility of the developer. Lackland solicitation, *supra* note 60, at sec. 1.0(b); Elmendorf solicitation, *supra* note 84, at sec. 1.3.2. Specifically, Elmendorf's solicitation required perspective developers to submit as part of their proposals, a Facilities Maintenance Plan addressing how they would handle grounds maintenance and pest control, among other maintenance issues. Elmendorf solicitation, *supra* note 84, at sec. 3.2.4.3.

<sup>225</sup> See Fort Hood RFQ, *supra* note 91, at pt. I, sec. 4.5.2; Elmendorf solicitation, *supra* note 84, at sec. 3.2.

<sup>226</sup> This question arose at Fort Carson. The legal office issued a legal opinion finding that pest control was the developer's responsibility under the terms of the contract. Memorandum from Phillip J. Wolf, Attorney-Advisor, Administrative and Civil Law Division, Fort Carson to Director of Environmental Compliance and Management, Fort Carson, subject: Use of Government Resources in the Privatized Housing Area – Tree Pruning/Removal and Pest Control (24 Apr. 2000) (on file with author). The opinion concluded that allowing the installation's Directorate of Environmental Compliance and Management office to spray for mosquitoes in the MHPI housing area would be an improper use of APFs and a violation of the Purpose Statute. *Id.* Interestingly, the Fort Carson developer suggested the possibility of using the Government's pest control office as a subcontractor. *Id.* The legal memo stated that this would also be impermissible for a variety of reasons, most importantly the lack of authority for the Government to be a subcontractor in this type of situation. *Id.* The opinion also concluded that APFs could not be used to remove or prune trees at the Commanding General's quarters because they were part of the MHPI housing area and the developer was contractually responsible for grounds maintenance. *Id.* Grounds maintenance under the contract specifically

analysis applies to repair of buildings. Repair and maintenance is generally the responsibility of the developer, as are upgrades to the units such as garage door openers or ceiling fans.<sup>227</sup>

The fiscal law issues addressed in this section do not represent a comprehensive listing of all the issues that have arisen or may arise in the future in the context of MHPI housing.<sup>228</sup> However, these examples serve three purposes. First, they evidence significant fiscal law implications in MHPI housing that did not exist with Government-owned housing. Second, they show the need for installation attorneys to work closely with the drafters of MHPI agreements to ensure the obligations of the parties are clearly defined. Third, armed with knowledge of fiscal law issues that may arise, installation attorneys can examine the MHPI agreements affecting their installations, assess the potential effect on the way their installation has been doing business and begin the process of educating commanders, contracting personnel and future tenants. Hopefully, early education will prevent surprises once the units are occupied and operational under the MHPI developer.

### C. Ethics Issues

The previous section discussed the fact that the ability of the Government to spend APFs on resident relations programs will generally be precluded or severely curtailed in MHPI projects because the developer will usually be contractually responsible for these programs. It might logically follow that the developer can now fund these programs without limitation or

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included tree pruning and removal/replacement. *Id.* The specific terms of the agreement must be reviewed before a determination is made on any fiscal law question. The MHPI statute was amended in 2000 to allow the Government to furnish utilities and enumerated services for MHPI housing located on the installation, and it now provides a mechanism for reimbursement for those services. National Defense Authorization Act for Fiscal Year 2001, Pub. L. No. 106-398, 114, Stat. 1654 (2000) (codified at 10 U.S.C. § 2872a). Specifically, the Government may furnish pest control and snow and ice removal, services that the Government typically provides in military family housing areas.

<sup>227</sup> See Lackland solicitation, *supra* note 60, at sec. 1.0(b); Elmendorf solicitation, *supra* note 84, at sec. 1.3.2.

<sup>228</sup> Fort Carson's legal office has compiled a list of lessons learned from its MHPI project. See E-mail from Maj Dru Brenner-Beck, Chief, Administrative and Civil Law, Fort Carson, to author (Nov. 9, 2000, 6:58 PM) (on file with author). Although this author has contacted other installations with current MHPI projects, it does not appear that similar efforts have been made to capture lessons learned at other MHPI installations. It is possible that other installations have not experienced fiscal law issues, or perhaps these issues were not identified as such and therefore were not coordinated with the legal offices. The Air Force has a growing collection of point papers and background papers identifying possible fiscal law and other issues associated with MHPI projects at its Wright-Patterson Air Force Base web site. Unfortunately, they generally provide little detail and little analysis, and so they are of differing levels of usefulness. Wright Patterson AFB, *Privatization Legal Issues*, <https://www.afmc-mil.wpafb.af.mil/HQ-AFMC/JA/lo/lojav/privatization/housing/index3.htm>.

further inquiry. However, the fact that the developer is contractually responsible for the program does not preclude the need for installation attorneys to ensure that the developer's actions under such a program do not violate the Standards of Ethical Conduct regulations (SOC)<sup>229</sup> and the Joint Ethics Regulation (JER).<sup>230</sup> In fact, a number of initiatives a developer may want to institute on the MHPI project, initiatives that would be considered normal commercial practice in a typical commercial housing development in the private sector, must first be examined for compliance with the SOC and the JER.<sup>231</sup> This section addresses the ethics implications of MHPI resident relations programs.

Developers may wish to provide MHPI housing tenants with special items as part of their resident relations programs. These might include welcome baskets upon move-in, free turkeys at Thanksgiving, block parties, tickets to local sporting events, and free house cleanings at move out for yard-of-the-month winners.<sup>232</sup> Currently, all tenants in MHPI projects are exclusively active-duty military members and their families.<sup>233</sup> Military members are federal employees subject to the ethics regulations regarding gifts from outside sources.<sup>234</sup> Absent an exception, regulations prohibit employees

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<sup>229</sup> Standards of Ethical Conduct for Employees of the Executive Branch, 5 C.F.R. § 2635 (2001).

<sup>230</sup> U.S. DEP'T OF DEFENSE, REG. 5500.7-R, JOINT ETHICS REGULATION, (Aug. 30, 1993) [hereinafter JER]. The JER is essentially a code of ethical conduct for Department of Defense employees, expanding upon and including the Standards of Conduct regulations. JER, Foreword (Aug. 30, 1993). It is grounded in the basic obligation of public service, which requires that "each employee has a responsibility to the United States Government and its citizens to place loyalty to the Constitution, laws and ethical principles above private gain." 5 C.F.R. § 2635.101. It sets forth a number of tenants Government employees must adhere to based on the notion that public office is a public trust. *Id.*

<sup>231</sup> Particularly relevant are the rules regarding gifts from outside sources. *Id.* §§ 2635.201-2635.204.

<sup>232</sup> Although not a complete list of the types of items a developer might wish to provide, these were actually proposed by the developer at Fort Carson. Telephone Interview with Maj Dru Brenner-Beck, *supra* note 64. It might be difficult to imagine why a developer would be interested in providing these "extras" when they have a ready-made tenant pool with significant waiting lists in most MHPI installations. They are provided for purely commercial reasons. First, the items might be the type of incentives the developer provides to other commercial developments it owns in the local community and it may want to provide them to military tenants so there is no perceived unequal treatment. More likely, however, because no MHPI contracts to date have provided rental guarantees, the developer may want to attract military tenants to ensure maximum occupancy in the units to maximize income to the developer.

<sup>233</sup> Telephone Interview with Maj Dru Brenner-Beck, *supra* note 64; Telephone Interview with Maurice Deaver, *supra* note 142.

<sup>234</sup> The JER defines a DoD employee as any DoD civilian officer or employee of any DoD component, active-duty Regular or Reserve military officer (including warrant officers), active-duty enlisted member of the Army, Navy, Air Force or Marine Corps and any Reserve or National Guard member on active duty under orders issued pursuant to title 10 of the United States Code. JER at 1-211. This definition includes a number of individuals eligible to

from directly or indirectly accepting a gift from a prohibited source or one given because of the employee's official position.<sup>235</sup> The developer would appear to have the same status as any other Government contractor and is, by definition, a prohibited source.<sup>236</sup> "Gift" is broadly defined, and would appear to encompass all the items listed above and any number of other items a developer might wish to give tenants in the context of a resident relations program.<sup>237</sup> Therefore, unless the item is excluded from the definition of a gift or falls into one of the exceptions, the tenants could not accept it without violating the JER.<sup>238</sup>

### *1. Move-in Incentives*

Developers of MHPI housing are commercial entities and, like other commercial housing providers, may want to provide incentives to entice tenants to occupy certain units.<sup>239</sup> This is particularly likely on installations where large numbers of housing units will be newly constructed or renovated. As the newly constructed or renovated units become available, it may be difficult to rent the older, as-yet unrenovated units.

Developers may wish to provide incentives for these hard-to-rent units in the form of reduced rent for the first month or free cable for a specified number of months.<sup>240</sup> The incentives are provided by a prohibited source, making the threshold issue whether the incentive is a gratuity or gift under the SOC and therefore prohibited from employee acceptance.<sup>241</sup>

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occupy MHPI projects according to the priority lists set forth in the MHPI agreements. *See, e.g.,* Lackland Solicitation, *supra* note 60, at sec. 3.1.9; Elmendorf solicitation, *supra* note 84, at sec. 3.3.4.6.

<sup>235</sup> 5 C.F.R. § 2635.202(a).

<sup>236</sup> Prohibited sources include, among others, any person who does business with the employee's agency. *Id.* at § 2635.203(d)(2). Nothing in the regulations indicates housing privatization developers are exempt from the definition of a prohibited source.

<sup>237</sup> "Gift" is defined as a "gratuity, favor, discount, entertainment, hospitality, loan, forbearance, or other item having monetary value. It includes services as well as gifts of training, transportation, local travel, lodgings and meals, whether provided in kind, by purchase of a ticket, payment in advance, or reimbursement after the expense has been incurred." *Id.* at § 2635.203(b).

<sup>238</sup> There are a number of exceptions to the definition of a "gift." *Id.* at § 2635(b). Most relevant to the MHPI developer's resident relations program are the exceptions for commercially available discounts and benefits at 5 C.F.R. § 2635.203(b)(4) and items secured by Government contract at 5 C.F.R. § 2635.203(b)(7).

<sup>239</sup> For example, the Fort Carson MHPI developer requested permission to provide move-in incentives for hard-to-rent housing units. These included units in undesirable locations, such as units near street intersections and those next to units with multiple dogs. Telephone Interview with Maj Dru Brenner-Beck, *supra* note 64.

<sup>240</sup> Fort Carson's developer requested the ability to provide similar incentive programs. *Id.*

<sup>241</sup> Office of Government Ethics, Opinion 99 X 1, Memorandum from Stephen D. Potts, Director, to Designated Agency Ethics Officials, subject: Employee Acceptance of Commercial Discounts and Benefits under the Standards of Ethical Conduct 5 C.F.R. Part

The definition of “gift” includes any discount having monetary value.<sup>242</sup> However, not every discount is a gift.<sup>243</sup> Specifically excluded from the definition of a gift are “opportunities and benefits, including favorable rates and commercial discounts, available to the public or to a class consisting of all Government employees or all uniformed military personnel, whether or not restricted on the basis of geographic considerations.”<sup>244</sup> In the case of MHPI move-in incentives, assuming they are available to anyone eligible to occupy the houses, they may fall under this commercially available discount exclusion.<sup>245</sup>

Another possible exclusion that would permit incentives as part of MHPI resident relations programs is the exclusion for items paid for by the Government or secured by the Government under contract.<sup>246</sup> This exclusion has been applied to items secured under lease agreements.<sup>247</sup> In a situation similar to move-in incentives in the MHPI context, the exclusion allows employees to accept discounted memberships to a health club built during the lease term in a building where the agency leases space.<sup>248</sup> The Office of Government Ethics (OGE) has stated that it is largely within the agency’s discretion to determine whether a benefit is “secured by Government contract.”<sup>249</sup> When a determination is made that the discount or benefit was secured under Government contract, that determination allows employees to

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2635(Jan.5, 1999), [http://www.usoge.gov/papers/advisory\\_opinions/advop\\_files/1999/99x1.txt](http://www.usoge.gov/papers/advisory_opinions/advop_files/1999/99x1.txt) [hereinafter OGE Opinion 99 X 1].

<sup>242</sup> 5 C.F.R. § 2635.203(b) (2001).

<sup>243</sup> OGE Opinion 99 X 1, *supra* note 241.

<sup>244</sup> 5 C.F.R. § 2635.204(b)(4).

<sup>245</sup> The pool of people eligible for the incentives may change depending on occupancy rates and priority lists, and this may change the analysis. At one extreme it would include military members eligible for Government housing; at the other extreme it would be open to the public. There is no question that discounts in the form of move-in incentives available to the general public are excluded from the definition of a gift. *Id.* at § 2635.203(b)(4); *see also* OGE Opinion 99 X 1, *supra* note 241. However, if the incentives were available only to a subgroup of military members, such as only those eligible for Government housing, the exclusion may not apply. *See* Office of Government Ethics, Informal Advisory Letter 92 X 26 (Dec. 10, 1992), [http://www.usoge.gov/papers/advisory\\_opinions/advop\\_files/1992/92x26.txt](http://www.usoge.gov/papers/advisory_opinions/advop_files/1992/92x26.txt) (indicating that the commercially available discount exclusion does not cover discounts or benefits to subgroups of employees).

<sup>246</sup> 5 C.F.R. § 2635.203(b)(7). The rationale for this exclusion is that items secured under a Government contract accrue to the employee from the Government, and therefore are not gifts from an outside source. OGE Opinion 99 X 1, *supra* note 241).

<sup>247</sup> Acceptance of discounted parking fees or concierge services provided for in an agency’s lease agreement for building spaces would fall under this exclusion. *Id.*

<sup>248</sup> *Id.*

<sup>249</sup> *Id.* Agencies have considered whether cellular phone service discounts offered to employees in their personal capacities by companies seeking to provide cellular service to the agency fall under the Government contract exclusion. *Id.* Some agencies have allowed such discounts, others have not. *Id.* However, the agency’s determination is what authorizes the exclusion. *Id.*

accept such discounts without running afoul of the gift prohibition.<sup>250</sup> In the case of MHPI projects, where a resident relations program is the developer's responsibility under the MHPI agreement with the Government, the Government may determine that move-in incentives are part of the resident relations program and therefore secured by the Government under the MHPI agreement. This determination would exclude such incentives from the definition of a gift and allow employee tenants to accept them.

In the alternative, if such incentives were found to be gifts, employees might accept them under the commercial discounts exception to the gift prohibition.<sup>251</sup> This exception provides that in addition to the opportunities and benefits excluded from the definition of gifts, employees may accept opportunities and benefits, including favorable rates and commercial discounts offered to members of a group or class in which membership is unrelated to Government employment.<sup>252</sup> The analysis here is focused on who is being offered the discount or benefit and the purpose or motive of the offeror.<sup>253</sup> In the case of MHPI housing, the developer is offering incentives to eligible tenants, typically a subgroup of military members. The question is whether the offer is related to Government employment.

The OGE has developed a three-part test to determine whether a discount or benefit is unrelated to Government employment. First, being a federal employee must not be a pre-requisite to be included in the group to which the discount is offered.<sup>254</sup> Under a resident relations program in an MHPI housing area, assuming that anyone eligible to occupy the houses is eligible for the incentives, then this prong is met.<sup>255</sup>

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<sup>250</sup> *Id.* In making such a determination, the agency is responsible for ensuring that the determination is otherwise appropriate under law, including procurement law and fiscal law regarding augmentation of appropriations. *Id.*

<sup>251</sup> 5 C.F.R. § 2635.204(c) (2001). If an employee accepts a gift that meets the criteria of a commercial discount or similar benefit under this section, it is deemed not to violate the gift prohibition, including those dealing with appearances. *Id.* at § 2635.204.

<sup>252</sup> *Id.* at § 2635.204(c)(2)(i).

<sup>253</sup> Note that gifts under this exception can be accepted even if the offeror of the gift is a prohibited source. OGE Opinion 99 X 1, *supra* note 241. *See also* Office of Government Ethics, Opinion 85 X 13, Memorandum from David H. Martin, Director, to Designated Agency Ethics Officials, subject: Acceptance of Commercial Discounts (Sept. 17, 1985), [http://www.usoge.gov/advisory\\_opinion/advop\\_files/1985/85x13.txt](http://www.usoge.gov/advisory_opinion/advop_files/1985/85x13.txt) [hereinafter OGE Opinion 85 X 13].

<sup>254</sup> *Id.* This prong focuses on the criteria for inclusion in the group.

<sup>255</sup> The priority lists contained in the MHPI agreements authorize other than federal employees to occupy the MHPI housing units, so a tenant does not necessarily have to be a federal employee. *See, e.g.*, Lackland Solicitation, *supra* note 60, at sec. 3.1.9; Elmendorf solicitation, *supra* note 84, at sec. 3.3.4.6. Thus, the group being offered the incentive is the pool of eligible tenants, who may or may not be federal employees.

Second, it must not appear that federal employees are being targeted.<sup>256</sup> Again, assuming that the incentives are available to all tenants in the MHPI housing area, this prong is met.<sup>257</sup>

Third, the employee seeking to accept the discount or benefit is not in a group or class that has some perceived or actual power, influence, or status associated with their jobs or positions in Government.<sup>258</sup> In the case of MHPI projects, the motivation of the developer in providing move-in incentives is purely commercial: to ensure that all units are rented, even those that are in undesirable locations within the project, or those that have yet to be rehabilitated. In addition, eligible tenants will be varied in their occupation and status, and will not generally be in a position to influence the business of the developer.<sup>259</sup> Thus, the third part of the test is met, and in most cases move-in incentives will qualify under the commercial discount exception, and may be offered by MHPI developers and accepted by MHPI tenants.

## 2. Resident Relations “Perks”

In addition to move-in incentives, MHPI developers may want to provide any number of “perks” as part of its resident relations program, such as welcome baskets, yard-of-the-month awards, and other benefits to tenants. The exclusions and exception discussed above are applicable to these extras as well as to the move-in incentives. In addition, some of these items may fall under the *de minimus* exception to the prohibition against accepting gifts from outside sources.<sup>260</sup> This exception permits the developer to give, and tenants to accept, gifts with an aggregate market value of \$20 per occasion, with a \$50 limit for the calendar year.<sup>261</sup> This would allow the developer to provide the tenants some “perks” as part of the resident relations program, but would limit

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<sup>256</sup> OGE Opinion 99 X 1, *supra* note 241.

<sup>257</sup> In the case of MHPI housing, if the incentives are targeted to the entire pool of eligible tenants, federal employees or civilians, then regardless of who the tenants are in actuality, federal employees are not being targeted.

<sup>258</sup> *Id.* This part of the test focuses on the offeror’s perceived motivation for offering the discount or benefit. *Id.* It attempts to prevent appearances of impropriety.

<sup>259</sup> Caution may still be needed regarding appearances, which may preclude certain tenants from accepting incentives even if all prongs are met. Concerns about the appearance of impropriety may preclude a particular employee from accepting an incentive or a gift that is offered to the general public or would otherwise be appropriate as a technical matter under the regulations. OGE Opinion 85 X 13, *supra* note 253. For example, military members working on contract administration or inspection for the MHPI contract should not take advantage of such incentives simply because of the appearance problems. *See* OGE Opinion 99 X 1, *supra* note 241 (indicating that even though federal employees are not being targeted, and even if there is no improper motive, employees should not accept discounts or benefits that appear to be offered because of the employee’s official job or position).

<sup>260</sup> 5 C.F.R. § 2635.204(a).

<sup>261</sup> *Id.*



the scope of the developer's program if that was the only applicable exception.<sup>262</sup>

If OGE determines the above exclusions and exceptions to the gift prohibition are inapplicable, the result will be a tenuous situation where the developer is required to provide a resident relations program for MHPI housing tenants, but as a practical matter is precluded or limited by the SOC and JER from carrying out those obligations. To date, neither OGE nor the Services have issued ethics opinions or guidance regarding the applicability of the SOC and JER to MHPI projects. This uncertainty may cause installations to err on the side of caution, advising developers against carrying out resident relations programs, regardless of the fact that they appear to be permissible under the exclusions and exceptions discussed above.<sup>263</sup>

If installations wish to provide more certainty regarding the permissibility of various resident relations programs, there are three possible methods of doing so. The first is to request an exception to SOC and JER prohibitions for resident relations programs in the context of MHPI projects.<sup>264</sup> This would allow MHPI developers to provide gifts and incentives, and tenants to accept them, without violating the gift prohibitions. This solution will take time to forward through the appropriate agencies for approval and may not be implemented expeditiously, if at all.

The second method can be implemented immediately but will only be useful for installations whose MHPI projects have not yet been finalized by award or closing. Using the Government contract exclusion to the gift prohibition,<sup>265</sup> the MHPI agreement can specifically define the nature, scope and extent of the resident relations program the developer will provide.<sup>266</sup> It

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<sup>262</sup> It would also create a need for tenants to be educated on the details of the ethics regulations to ensure they do not run afoul of the law. Additionally, it could become a record-keeping nightmare for the developer as well as the tenants to police the yearly limit.

<sup>263</sup> Fort Carson has addressed its ethics concerns by using other methods for its MHPI developer to participate in the community, such as commercial sponsorship and co-sponsorship, rather than using the exclusions and exceptions to the gift prohibition that would allow a substantially more robust resident relations program. *See*, Memorandum from Captain (Capt) James A. Barkei, Administrative Law Attorney, Fort Carson to McDonald Kemp, Directorate of Community Activities, Fort Carson, subject: Proposed Joint Events with Directorate of Community Activities and J.A. Jones (5 Apr. 2000) (on file with author) [hereinafter Barkei Joint Events Memo].

<sup>264</sup> The exception should apply whether the resident relations program is specifically defined in the MHPI agreement or simply part of the developer's overall responsibility for the operation and maintenance of the housing project. Fort Carson has requested a JER exception for privatized housing projects, which has been forwarded to the Department of the Army's General Counsel's office for review. *Id.*

<sup>265</sup> 5 C.F.R. § 2635(b)(7).

<sup>266</sup> If a resident relations program is part of the MHPI agreement from the outset, and if it is defined broadly, it would seem to fall within the exception as something secured by the Government under contract. *Id.* Fort Carson is exploring the possibility of defining the scope of the resident relations program that was part of the original contract. E-mail from Maj Dru

should be clear that it is part of the Government's benefit of the bargain and part of the consideration for its financial participation. Although not necessary, ideally the solicitation should include a resident relations program as one consideration in the overall evaluation of the proposal. Thus, by contracting for the resident relations program as part of the MHPI project and defining its scope, it becomes more difficult to argue that it does not fall under the Government contract exclusion.<sup>267</sup>

The final solution is an interim fix for installations whose MHPI projects were finalized without the inclusion of a resident relations program. As discussed above, installations should take advantage of the various exclusions and exceptions that are applicable to a particular benefit, discount or gift developers may wish to provide to tenants. In addition, the developer may be able to co-sponsor events with DoD components or organizations that MHPI tenants could attend, along with the rest of the community.<sup>268</sup> For example, Fort Carson co-sponsored a groundbreaking ceremony with its MHPI developer as a community event under the JER provisions authorizing co-sponsorship and logistical support of non-federal entities.<sup>269</sup>

If the developer wants to contribute to community events or participate in installation celebrations such as open houses or air shows, two possible authorities exist to accommodate such requests. First, each of the Services has regulations governing Morale, Welfare and Recreation (MWR) programs and Non-Appropriated Fund Instrumentalities (NAFI). Depending on the specific Service regulations, the developer may be able to participate in MWR programs by providing items of support for the program. This is an ideal way for the developer to contribute to annual MWR programs and support the installation community as a whole.<sup>270</sup>

Commercial sponsorship is the second way a developer might participate in community events on the installation. Commercial sponsorship programs differ in each Service, but generally permit commercial entities to

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Brenner-Beck, *supra* note 221. Although Fort Carson may have bargained for a resident relations program, the contract provided no detail regarding what it included. *Id.*

<sup>267</sup> Installations may want to consider placing limits on the resident relations program rather than allowing the developer's initiatives to go unchecked. The Government must still be conscious of appearances of improper or unethical conduct by its employees. However, as long as the resident relations program at the MHPI project is similar to what this or other commercial developers provide to tenants of private sector housing projects, there should be no perception problems.

<sup>268</sup> JER at 3-206.

<sup>269</sup> *Id.* and at 3-211. The groundbreaking was a community focused celebration and was unrelated to the construction business of the developer. Memorandum from Captain (Capt) James A. Barkei, Administrative Law Attorney, Fort Carson to Garrison Commander, Fort Carson, subject: CVI Groundbreaking Ceremony (25 Feb. 2000) (on file with author) [hereinafter Barkei Groundbreaking Memo].

<sup>270</sup> The MHPI developer at Fort Carson donated Easter eggs to the NAFI for an MWR sponsored Easter egg hunt that was open to MWR eligible patrons, not just the developer's tenants. Barkei Joint Events Memo, *supra* note 263.

help finance enhancements for MWR events, activities and programs.<sup>271</sup> Commercial sponsors are typically permitted to advertise, distribute literature, display signs and are recognized as a commercial sponsor of the event.<sup>272</sup> Commercial sponsorship is an appropriate way for an MHPI developer to support the installation community at open houses, air shows, and other large events hosted by the installation.

Although the ethics regulations may limit what a developer can do in terms of resident relations programs, particularly if such programs were not included in the MHPI agreement, there are a variety of ways to resolve these complications. The preferable resolution is a long term one in the form of a general exception to the stringent SOC and JER limitations for MHPI developers when performing resident relations programs. This exception should apply regardless of whether the resident relations program is specifically included in the agreement between the parties, or can be inferred from the developer's overall responsibility for the operation and maintenance of the MHPI housing area. However, even in the short-term, MHPI developers can legally initiate resident relations programs and participate in community events with a little careful planning and attention to the SOC, JER and other Service regulations.

#### **D. Environmental Law Issue -- Historic Preservation**

The DoD has been dealing with environmental compliance issues throughout its history, especially since the 1970s and 1980s when the country witnessed an explosion of environmental legislation.<sup>273</sup> With a number of installations on the National Priority List for environmental clean-up, environmental awareness and monitoring of installation operations and of actions taken on and off the installation are routine. The Services have learned to deal with environmental issues associated with common activities such as construction and equipment maintenance as part of their daily responsibilities.<sup>274</sup> However, when a new process, procedure or activity is

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<sup>271</sup> U.S. DEP'T OF AIR FORCE, INSTR. (AFI) 34-407, AIR FORCE COMMERCIAL SPONSORSHIP PROGRAM, para. 1.1 (17 Feb. 1999).

<sup>272</sup> U.S. DEP'T OF ARMY, REG. (AR) 215-1, Morale, Welfare, and Recreation Activities and Nonappropriated Fund Instrumentalities, para. 7-47 (25 Nov. 1998).

<sup>273</sup> See, e.g., National Environmental Policy Act, Pub. L. No. 91-190, 83 Stat. 852 (1970) (codified at 42 U.S.C.A. § 4321 (West 2000)); Endangered Species Act of 1973, Pub. L. No. 93-205, 87 Stat. 884 (codified at 16 U.S.C.A. § 1531 (West 2000)); Comprehensive Environmental Response, Compensation, and Liability Act of 1980, 42 U.S.C.A. § 9601 (West 2000).

<sup>274</sup> See, e.g., U.S. DEP'T OF AIR FORCE, INSTR. (AFI) 40-201, MANAGING RADIOACTIVE MATERIALS IN THE U.S. AIR FORCE (Sept. 1, 2000); U.S. DEP'T OF AIR FORCE, PAM. (AFPAM) 32-7043, HAZARDOUS WASTE MANAGEMENT GUIDE (Nov. 1, 1995); U.S. DEP'T OF AIR FORCE, INSTR. (AFI) 21-202, COMBAT AMMUNITION SYSTEM PROCEDURES (July 1, 1995); U.S. DEP'T OF ARMY, PAM. 200-1, HANDBOOK FOR ENVIRONMENTAL IMPACT ANALYSIS (July 4, 2000); U.S. DEP'T OF ARMY, REG. (AR) 200-1, ENVIRONMENTAL

introduced, the Services must step back and determine the applicability of the environmental statutes and potential liability for failing to comply.

The MHPI authority, whereby the Government conveys houses to a developer, leases land to the developer and contributes financially to the project, has given rise to a new way of doing business.<sup>275</sup> The Services need to assess how different environmental statutes apply to MHPI transactions. As was illustrated, for example, by the Fort Carson project, the applicability of the National Historic Preservation Act should be considered.<sup>276</sup>

The National Historic Preservation Act of 1966 (NHPA) is a procedural statute similar to the National Environmental Policy Act (NEPA).<sup>277</sup> It requires federal agencies to consider the effect of any federal or federally assisted undertaking on any district, site, building, structure or other object included in, or eligible for inclusion in, the National Register.<sup>278</sup> If the NHPA applies to the agency's activity, then a consultation process referred to as the Section 106 process is triggered.<sup>279</sup> In order to comply with the law, the agency must identify properties or areas that are eligible for inclusion on the National Register, determine whether the proposed activity may adversely affect the property or area, and consult with the State Historic Preservation Officer (SHPO).<sup>280</sup>

To determine whether NHPA applies to MHPI projects, the agency must first determine whether MHPI is a federal or federally assisted undertaking.<sup>281</sup> Second, the agency must determine whether the houses, or any areas encompassed by the MHPI project, are eligible for inclusion in the National Register.<sup>282</sup>

As is the case with NEPA and other environmental statutes, the NHPA is broadly written to maximize its protections. NHPA defines, for example, a federal or federally assisted undertaking as any –

project, activity, or program funded in whole or in part under the direct or indirect jurisdiction of a Federal agency, including those carried out by or on behalf of a Federal agency; those carried out with Federal financial assistance; those requiring a Federal permit, license or approval; and those subject to State or local regulation administered pursuant to a delegation or approval by a Federal agency.<sup>283</sup>

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PROTECTION AND ENHANCEMENT (Feb. 21, 1997); U.S. DEP'T OF ARMY, REG. (AR) 200-2, ENVIRONMENTAL EFFECTS OF ARMY ACTIONS (Dec. 23, 1988).

<sup>275</sup> 10 U.S.C. § 2871.

<sup>276</sup> Telephone Interview with Maj Dru Brenner-Beck, Chief, *supra* note 64.

<sup>277</sup> 16 U.S.C.A. § 470 (West 2000).

<sup>278</sup> *Id.* at §470(f). The "National Register" is the National Register of Historic Places that is maintained by the Secretary of the Interior. 36 C.F.R. § 800.16(q) (2001).

<sup>279</sup> 36 C.F.R. § 800.16(f).

<sup>280</sup> 16 U.S.C. § 470(f).

<sup>281</sup> *Id.*

<sup>282</sup> *Id.*

<sup>283</sup> 36 C.F.R. § 800.16(y) (2001).

Based on the financial structure of MHPI projects, with the Government providing direct loans and loan guarantees, it is difficult to argue MHPI projects are exempt from the definition of a federal or federally assisted undertaking.<sup>284</sup> Courts have found Federal undertakings to include building leases,<sup>285</sup> direct financial assistance for housing projects,<sup>286</sup> and loan guarantees.<sup>287</sup>

Additionally, MHPI projects do not proceed without agency approval regarding the details of the housing construction/renovation, community design, and other aspects of the project.<sup>288</sup> It is likely that this agency approval is sufficient to qualify MHPI projects as a federal undertaking under NHPA.

The second prerequisite for NHPA applicability to MHPI projects is that the houses, or areas involved in the project, are eligible for inclusion in the National Register.<sup>289</sup> The criteria used in determining whether buildings, districts, sites, structures or other objects are eligible for inclusion in the National Register include the quality of their significance in American history and culture.<sup>290</sup> It can include structures and areas associated with events that have made a significant contribution to the broad patterns of our history, or property achieving significance within the past 50 years if it is of exceptional importance.<sup>291</sup>

Many current MHPI projects require the demolition or renovation of houses that were built in the Cold War Era (1949-1989).<sup>292</sup> The Cold War was

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<sup>284</sup> On the Lackland project, the Government provided a direct loan to the developer for \$10.6 million. 2000 *Hearings, supra* note 7 (statement of Randall A. Yim, Deputy Under Secretary of Defense, Installations). Fort Carson's MHPI agreement included a loan guarantee to the developer for a private sector loan. *Id.* The Navy provided its developer with \$9.5M as capital for its joint venture to build housing in Corpus Christi, Texas. *Id.*

<sup>285</sup> *Birmingham Realty Co. v. General Servs. Admin.*, 497 F. Supp. 1377 (N.D. Ala. 1980).

<sup>286</sup> *Wicker Park Historic Dist. Preservation Fund v. Pierce*, 565 F. Supp. 1066 (N.D. Ill. 1982).

<sup>287</sup> *Carson v. Alvord*, 487 F. Supp. 1049 (N.D. Ga. 1980).

<sup>288</sup> *See, e.g.*, Fort Hood RFQ, *supra* note 91, at pt. I, sec. 2.1 (requiring completion of CDMP acceptable to the Government); Lackland solicitation, *supra* note 60, at app. A, exhibit G (setting forth requirements for substantial Government inspection and oversight of construction and renovation); Elmendorf solicitation, *supra* note 84, at sec 3.2.6.5 (requiring Government to issue a Certificate of Occupancy to developer when developer has complied to Government's satisfaction with all applicable codes, standards, regulations, drawings, plans and specifications).

<sup>289</sup> 16 U.S.C.A. § 470(f) (West 2000).

<sup>290</sup> 36 C.F.R. § 60.4 (2001).

<sup>291</sup> *Id.*

<sup>292</sup> Lackland AFB project included demolition of 272 Wherry housing units constructed under 1950s privatization legislation. Lackland solicitation, *supra* note 60, at sec. 3.1.1. The Elmendorf AFB MHPI project contemplates conveying 176 units built in 1965 to the developer, 24 of which would be demolished. Elmendorf solicitation, *supra* note 84, at sec. 2.4.2. Fort Hood and Fort Carson both have significant numbers of housing units that involved in MHPI projects that were constructed during the Cold War. Fort Hood RFQ, *supra* note 91, at pt. II, app. A, sec. 1.2.

exceptionally important in American history and was significant in the development of the American culture. Military installations were central in the Cold War; consequently various buildings, structures, sites and objects, including housing areas located on military installations may meet the eligibility criteria for inclusion on the National Register.<sup>293</sup>

Even if the houses themselves are not eligible, the agency must use caution if the houses are in the area of any listed or eligible structures or districts. Housing alteration, new construction or demolition could have an adverse effect on other eligible or listed structures or districts.<sup>294</sup> In that case, the MHPI project would be subject to the Section 106 process even though the houses themselves were not eligible properties.

Fort Carson considered whether the NHPA applied given that houses had been transferred to the developer.<sup>295</sup> The “undertaking,” however, is the commencement of the MHPI project, the awarding of the contract, or closing of the real estate transaction; and the NHPA requires consideration of the effect of federal undertakings that may result in changes to eligible or listed buildings or areas *before* approval of the undertaking.<sup>296</sup> Thus, the relevant time period for determining applicability of the NHPA is necessarily prior to the conveyance of the houses and lease of the land.

Fort Carson faced one other NHPA challenge that deserves mention as a lesson learned for other installations. Under its agreement with the developer, Fort Carson agreed to provide the developer a Government building as a base of operations for the first two years of the project.<sup>297</sup> The building selected was part of a listed Historic District under a preservation plan between the installation and the SHPO.<sup>298</sup> The developer wished to make modifications to the building that could not be made because of the building’s status.<sup>299</sup> Fort Carson had to comply with the Section 106 consultation process and work with the SHPO to get agreement regarding the modifications after the building had already been selected and turned over to the developer.<sup>300</sup>

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<sup>293</sup> Ronald Forcier and David Hoard, *The National Historic Preservation Act Environmental Law Primer*, para. 3, at [https://aflsa.jag.af.mil/groups/air\\_force/envlaw/primers/nhpaperim.htm](https://aflsa.jag.af.mil/groups/air_force/envlaw/primers/nhpaperim.htm). See also Hatfield Memo, *supra* note 143 (indicating Cold War resources may be eligible for inclusion on the National Register).

<sup>294</sup> Pursuant to regulation, adverse effects include the introduction of visual or audible elements that diminish the integrity of the property’s significant historic features. 36 C.F.R. § 800.5(a)(2)(v). It also includes any change of the character of the property’s use or of physical features within the property’s setting that contributes to its historic significance. *Id.* § 800.5(a)(2)(iv).

<sup>295</sup> Telephone Interview with Maj Dru Brenner-Beck, *supra* note 64.

<sup>296</sup> 16 U.S.C. § 470(f).

<sup>297</sup> Telephone Interview with Maj Dru Brenner-Beck, *supra* note 64.

<sup>298</sup> *Id.*

<sup>299</sup> *Id.*

<sup>300</sup> *Id.*

Prior to commencement of any MHPI project, the installation must consider the impact of the NHPA on the proposed project. It should examine the houses and other areas projected to be part of the MHPI project, as well as any surrounding eligible structures or areas potentially affected by MHPI. The exact terms of the MHPI financial structure should be considered to determine if it qualifies as a federal undertaking. If the NHPA is applicable, the Section 106 process must be followed, including notification to and consultation with the SHPO regarding any adverse effects. In addition, if the Government provides Government buildings to the developer as part of the MHPI arrangement, they should be ones not subject to NHPA requirements. If that is not possible or practical, then the developer must be notified and the installation should begin coordination with the SHPO early in the process to minimize delays and frustration.

## V. CONCLUSION

This article addresses only a very small fraction of the MHPI-related issues that challenge policy makers, attorneys, commanders, contracting personnel, MHPI tenants and developers. The issues encompass the entire spectrum of law, requiring examination of contract, fiscal, criminal, ethical, and environmental law implications. If recognized early in planning an MHPI project, they can be squarely and effectively addressed. It is important for legal advisors to understand that, at present, what MHPI guidance does exist is both informal and non-centralized, coming from diverse activities across the DoD. While this environment may make effective planning difficult for Air Force organizations, it represents an opportunity for legal counsel to serve an indispensable role in identifying and resolving issues, thereby significantly contributing to the success of MHPI projects.

# UTILITY PRIVATIZATION IN THE MILITARY SERVICES: ISSUES, PROBLEMS, AND POTENTIAL SOLUTIONS

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## I. INTRODUCTION

The Department of Defense (DoD) issued Defense Reform Initiative Directive No. 9 (“DRID No. 9”), “Privatizing Utility Systems,” on 10 December 1997, thus launching the DoD’s Utility Privatization initiative. It directed the military departments “to develop a plan for privatizing all of their utility systems (electric, water, waste water and natural gas) by January 1, 2000, except those needed for unique security reasons, or when privatization is uneconomical.”<sup>1</sup> Defense Reform Initiative Directive No. 49, “Privatizing Utility Systems” (“DRID No. 49”), came along a year later, fleshing out the DRID No. 9 mandate and extending the date for the military services to award utility privatization contracts for all eligible utility distribution systems to no later than 30 September 2003.<sup>2</sup> Defense Reform Initiative Directive Nos. 9 and 49 were issued pursuant to authority granted by Congress in 10 U.S.C. § 2688,<sup>3</sup> which allowed, but did not require, federal agencies, including the military services, to privatize their utility systems.

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<sup>1</sup> U.S. DEP’T OF DEFENSE, OFFICE OF THE DEPUTY SECRETARY OF DEFENSE, DEFENSE REFORM INITIATIVE DIRECTIVE NO. 9 (Dec. 1997) [hereinafter “DEFENSE REFORM INITIATIVE DIRECTIVE NO. 9”].

<sup>2</sup> U.S. DEP’T OF DEFENSE, OFFICE OF THE DEPUTY SECRETARY OF DEFENSE, DEFENSE REFORM INITIATIVE DIRECTIVE NO. 49 (Dec. 1998) [hereinafter “DEFENSE REFORM INITIATIVE DIRECTIVE NO. 49”].

<sup>3</sup> As provided by 10 U.S.C. § 2688(a) (1997):

CONVEYANCE AUTHORITY. – The Secretary of a military department may convey a utility system, or part of a utility system, under the jurisdiction of the Secretary to a municipal, private, regional, district, or cooperative utility company or other entity. The conveyance may consist of all right, title, and interest of the United States in the utility system or such lesser estate as the Secretary considers appropriate to serve the interests of the United States.



Implementation of the directives has proved troublesome. Defense Reform Initiative Directive No. 49 set out an interim milestone – that utility privatization solicitations for all eligible-to-be-privatized systems be released “on the street” no later than 30 September 2001.<sup>4</sup> None of the services met this milestone. The fact that this milestone was not met by any of the services is indicative of the problems facing utility privatization implementers. This article will explore four<sup>5</sup> of the more difficult legal issues challenging both policy-makers in the military services and utility privatization implementers at the installation-level, where “the rubber meets the road.”<sup>6</sup>

The first “issue” is an overarching one that is more of a policy discussion than a legal issue. Considering that the military services have not met the DRID No. 49 interim milestone to have all utility privatization solicitations released by 30 September 2001, what is the likelihood they will meet the 30 September 2003 deadline to have all eligible utility systems privatized? Further, is the 30 September 2003 deadline wise; is it in the best interest of the services? The Department of Defense very recently answered

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<sup>4</sup> DEFENSE REFORM INITIATIVE DIRECTIVE NO. 49, *supra* note 2.

<sup>5</sup> This article as originally drafted discussed a fifth issue – The contract cost principle (FAR 31.205-20, Interest and other financial costs) prohibits contractors from collecting interest expense on their borrowings. This provision did not allow utility privatization contractors to merely collect the expense entailed by borrowing money, and negated one of the basic premises justifying utility privatization. That premise is that DoD does not have the funds necessary to upgrade and maintain its utility systems, but will obtain these needed upgrades via the utility privatization contractors who will obtain the funding necessary for the upgrades. However, if the utility privatization contractors were not permitted to collect their interest expense, this would probably make their borrowing too expensive and therefore untenable. Congress enacted legislation in Fall 2001, S. 1438, 107<sup>th</sup> Congress, 1<sup>st</sup> session. S. 1438 (2001), requiring the Secretary of Defense to determine whether FAR 31.205-20 should be modified to allow utility privatization contractors to collect their interest expense on borrowings. On 15 April 2002, Deidre A. Lee, the Director of DoD Procurement, authorized a class deviation from FAR 31.205-20’s cost principles. “Pursuant to this deviation, the utilities privatization contractor will be permitted to recover its interest costs associated only with capital expenditures to acquire, renovate, replace, upgrade, and/or expand utility systems...” The DoD solved the problem therefore by modifying the FAR provision, and a more detailed discussion of the issue was removed from this article. *See* FAR 31.205-20.

<sup>6</sup> By no means will this article attempt to address the myriad of legal issues and problems involved in utility privatization implementation in the military services. Issues such as the legality/propriety of the economic analysis model, i.e., inclusion of “should costs” in comparing status quo Government ownership of utility systems versus privatized ownership; conflicts of interest presented by utility privatization A-E consultants bidding on solicitations; the so-called “POM disconnect” (privatized versus Government ownership of utility systems will cost more, but this additional expense has not been budgeted); leasing as an alternative to privatization; and combining privatization with other DoD energy programs such as energy conservation, will not be addressed. These issues are mentioned so that the reader will understand there are other challenging issues that he/she may have to confront in the utility privatization arena, in addition to those discussed in this article.

“no” to this question, and apparently the deadlines will be pushed further back.<sup>7</sup>

The second issue is what effect, if any, state law has upon the utility privatization contractor selection process and upon the subsequent contractual relationship between military installations and the selected utility privatization contractors. The article will also address whether installations should desire, and enthusiastically accept, state regulation of their relationship with the utility privatization contractor, irrespective of whether Federal law preempts state law in these areas.

The third issue addressed is a very practical one. What happens if the utility privatization contractor fails to perform satisfactorily during the life of the utility service contract? Further, what happens at the end of the fifty-year service contract and what type of bargaining position will the installation be in, considering that the contractor owns the utility system and is in effect “the only game in town?” Remedies available to the government in the event of contractor default, and in the event the government and contractor are unable to successfully negotiate a follow-on to the initial fifty-year service contract, will be explored.

The fourth and final issue concerns use of the Federal Acquisition Regulation (FAR) contract clauses and compares the “Negotiated Rates” clause<sup>8</sup> against the “Regulated Rates” clause<sup>9</sup> in utility service contracts with municipal utility privatization contractors. Part 241 of the Defense Federal Acquisition Regulations (DFARS)<sup>10</sup> requires that utility service rates between federal agencies and municipal utility companies be negotiated. Many municipal utility companies hold a different view, believing they are entitled to use of the Regulated Rates clause. This dispute caused the breakdown of utility privatization negotiations between an Air Force base and a municipal utility company, and is a thorny issue that may also adversely affect future negotiations between military installations and municipal utility companies.

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<sup>7</sup>George Cahlink, “*Pentagon retools plans to privatize utilities at military bases*,” GovExec.com (April 16, 2002) <<http://www.govexec.com/dailyfed/0402/041602g1.htm>> (“By June, the Defense Department will issue new rules for utility privatization that push back the 2003 deadline by a year or two...”).

<sup>8</sup> FEDERAL ACQUISITION REG (FAR) 52.241-8, Change in Rates or Terms and Conditions of Service for Unregulated Services (Feb. 1995).

<sup>9</sup> FAR 52.241-7, Change in Rates or Terms and Conditions for Regulated Services (Feb. 1995).

<sup>10</sup> U.S. DEP’T OF DEFENSE, DEFENSE FEDERAL ACQUISITION REG. SUPP. (DFARS) PART 241 (Jan. 13, 2000).

## II. BACKGROUND

### A. What is Utility Privatization, and Why Does DoD Want To Do It?

Utility Privatization is the sale of government-owned on-base utility distribution systems to a private entity that will then operate the systems and provide utility services to the base's buildings and activities.<sup>11</sup> It is important to distinguish "privatization" from "contracting out" and "outsourcing." Unfortunately, many times these terms are used interchangeably, causing confusion. Basically, in utility privatization, the government is selling its on-base utility distribution systems – electric, natural gas, water, and wastewater systems – to private entities. The contractor buying these systems will then own them and will be responsible for their operation and maintenance. The government is *not* retaining ownership of the systems and contracting-out their operation and maintenance to a private entity. It is selling the systems outright.<sup>12</sup>

The DRID No. 49 objective is "to get DoD out of the business of owning, managing, and operating utility systems by privatizing them."<sup>13</sup> The DoD has issued draft utility privatization guidance, which is expected to be released in final format in the near future. The draft guidance states in part:

[T]he purpose of privatization is to allow the Defense Components to focus on core defense missions and functions by relieving them of those installation management activities that can be done more efficiently and effectively by others. Historically, military installations have been unable

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<sup>11</sup> 10 U.S.C. § 2688. *See generally* Lt Colonel Bill C. Wells, Through the Looking Glass (quickly) – A Brief Introduction to Utilities Privatization With a Special Focus on Environmental Concerns (1999) (on file with author) ("Today most all Air Force bases are no longer islands off by themselves, but are heavily integrated with the utility systems of their surrounding communities. What privatization is going to do is move the point of connection to the outside systems from the base boundary to the individual building."). Lt Colonel Wells is presently the Chief of the Air Force Utility Litigation Team, Air Force Legal Services Agency, Tyndall AFB, Florida.

<sup>12</sup> *See generally* Wells, *supra* note 11.

Privatization differs from contracting out (e.g. A-76) in that in a contracting out situation the contractor is hired to run a utility system for a period of time, but the government continues to own the system and remains responsible for planning and paying for maintenance, improvements and upgrades. Another way that privatization differs from mere contracting out is that it is well nigh [sic] irreversible. Once a privatization deal is complete the government no longer holds title to the utility system – and the rules do not even allow you to have a reversionary interest, though you can, and probably should arrange to have a right of first refusal if the new owner ever decides to sell your system.

*Id.*

<sup>13</sup> DEFENSE REFORM INITIATIVE DIRECTIVE NO. 49, *supra* note 2.

to fully upgrade and maintain utility systems due to inadequate funding and competing installation management priorities. Utilities privatization will allow military installations the opportunity to benefit from private sector financing and efficiencies to obtain improved utility systems and services.<sup>14</sup>

One commentator suggests another rationale for DoD utility privatization, stating “[i]n the government budget process, it is much easier for the services to ask for and receive ‘utility operating dollars’ (which is the classification of the privatization payments made to a utility) than capital dollars to rebuild the systems.”<sup>15</sup> If indeed this is DoD’s logic, it is questionable. This logic assumes that although military installations cannot convince Congress to properly fund upgrades to military-owned utility systems, Congress will view utility bills as “must pay” items. Therefore, needed upgrades to military utility infrastructure will be obtained by selling the systems to private entities, who will then upgrade the systems and incorporate the cost of upgrades in their utility bills to the installations -- a convoluted, but apparently necessary means of obtaining properly functioning utility systems.

## **B. What Exactly is Being Privatized?**

Although 10 U.S.C. §2688 authorized military services to convey steam, hot and chilled water, and telecommunications systems to private entities, DRID No. 9 focused on the so-called “Big 4” utility systems – electric, water, wastewater, and natural gas.<sup>16</sup> The term “utility systems” refers to an installation’s electric, water, wastewater, and natural gas utility distribution systems. It refers to utility infrastructure – wires, pipes, mains, switching stations, and transformers. Basically, it involves the utility infrastructure that connects the base to the off-base commodity supplier and connects the various buildings on the installation. It does not include wiring and piping found inside buildings.<sup>17</sup>

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<sup>14</sup> Draft Policy Guidance, Office of the Deputy Undersecretary of Defense (Installations & Environment), subject: Privatizing Defense Utility Systems (undated) (on file with author) [hereinafter “Draft Policy Guidance.”].

<sup>15</sup> Steven J. Allenby, *Military Utility Privatization: A Good Tactic for Distribution Companies?*, E-SOURCE (Oct. 1998) <[http://www.esource.com/members/e\\_cd/pdfs/er9808.pdf](http://www.esource.com/members/e_cd/pdfs/er9808.pdf)> (“The U.S. Military is part of a worldwide trend toward privatization. The trend is fueled by an organization’s desire to focus on its core competencies and to farm out other elements of its operations to experts that can accomplish them more cost-effectively. In the military’s case, there is an additional motivation for privatization: as an opportunity to rebuild a neglected utility infrastructure.”).

<sup>16</sup> DEFENSE REFORM INITIATIVE DIRECTIVE NO. 9, *supra* note 1.

<sup>17</sup> DEFENSE REFORM INITIATIVE DIRECTIVE NO. 49, *supra* note 2. A “utility system” is defined as

any system for the generation and supply of electric power, for the treatment or supply of water, for the collection or treatment of wastewater,

### C. What “Service” Will the Utility Privatization Contractor Provide?

When an installation privatizes its on-base electric distribution system, for example, the entity buying the system (the “utility privatization contractor”) will own the system, and will operate and maintain the system. The “service” provided by the utilities privatization contractor thereafter is the operation and maintenance of the distribution system, presumably ensuring the flow of electricity to those installation buildings requiring it. The actual electricity, the electrons being distributed over the now contractor-owned system, typically will not be generated or provided by the utility privatization contractor. In fact, both the Army and Air Force utility privatization Request for Proposal (RFP) templates specifically state the “commodity” is not included in the utility service contract and will not be provided by the utility privatization contractor.<sup>18</sup>

In a utility privatization scenario, you could have Electric Utility Company A delivering the commodity (electricity) to the installation substation, formerly owned and operated by the installation but now owned by Utility Privatization Contractor B, to then be distributed to all the installation’s buildings and facilities requiring a supply of electricity, over a distribution system formerly owned by the installation, but now owned by Utility Privatization Contractor B. Alternatively, it is possible that Electric Utility Company A could be selected as the Utility Privatization Contractor, in which case, it would be providing both the commodity (the electricity, the electrons) to the base, as well as distribution services over the on-base electric distribution system it just purchased. However, in that scenario, Electric Utility Company A will continue to provide the electricity commodity, the

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and for the supply of natural gas. For the purpose of this definition, supply shall include distribution. A utility system includes equipment, fixtures, structures, and other improvements utilized in connection with the systems described above, as well as the easements or rights-of-way associated with those systems. A utility system does not include any projects constructed or operated by the Army Corps of Engineers under its civil works authorities nor does it include any interest in real property other than an easement or right-of-way associated with the utility system.

*Id.*

<sup>18</sup> AIR FORCE CIVIL ENGINEER SUPPORT AGENCY, TEMPLATE FOR COMPETITIVE SOLICITATIONS, REQUEST FOR PROPOSAL (RFP) (1 June 2000) <<http://www.afcesa.af.mil/Directorate/CEO/Contracts/UtilPrivatization/Uppage.htm#Template>> [hereinafter “AIR FORCE RFP TEMPLATE”]; DEFENSE ENERGY SUPPORT CENTER/U.S. ARMY, PRIVATIZATION SOLICITATION TEMPLATE, (1 Oct. 2001) <<http://www.hqda.mil/acsimweb/fd/policy/utilitiespricur.htm>> [hereinafter “ARMY RFP TEMPLATE”]. The website states the Army Assistant Chief of Staff for Installation Management (ACSIM) encourages the widespread use of the RFP template by Army installations.

electrons, to the installation pursuant to a different contract, and not pursuant to the utility privatization service contract.<sup>19</sup>

Military installations located in states that have not deregulated their electric industries typically buy their electricity from a state-regulated entity colloquially known as the “local utility.” Section 8093 of the Fiscal Year 1988 DoD Appropriations Act<sup>20</sup> requires Federal agencies to purchase electricity in a manner consistent with state law. Section 8093 is implemented in Federal procurement policy.<sup>21</sup> In those states that have *not* deregulated, state utility regulatory commissions have generally granted the exclusive right to provide electric service within certain designated territories to regulated utility companies. A military installation falling within one of those state commission-designated territories is required therefore to purchase its electricity from the utility company holding the service territory franchise. In those states that *have* deregulated their electric industries, the military installations, along with other electric customers, are given the right to purchase their electricity on the open market, from electric generation power-producing companies, and not just from the “local utility.” States are deregulating their electric industries on a piecemeal basis and this process, although occurring at the same time as utility privatization, is not related to it.

#### **D. How Will Privatization be Accomplished?**

In the typical scenario, a military installation will conduct a competitive solicitation for its utility privatization project. Once the successful offeror is selected, the installation will enter into three separate agreements with the

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<sup>19</sup> See generally DEP’T OF DEFENSE, PROCUREMENT OF ELECTRICITY FROM MOST ECONOMICAL SOURCE – REPORT TO CONGRESS 8 (Mar. 26, 1996), cited in Christopher J. Aluotto, *Privatizing and Combining Electricity and Energy Conservation Requirements on Military Installations*, 30 PUB. CONT. L.J. 723, 725 (Summer 2001).

A military installation is similar to a small town in size and structure and includes many of the attributes of any town, such as housing areas, grocery stores, hospitals, churches, and shopping centers. Each facility is connected to a complex network of utility infrastructure consisting of electric, natural gas, water/wastewater, and telecommunications systems. ... Most installations do not generate electricity but instead buy it from an electric utility company. The utility company delivers electricity at high voltage to an electric substation normally located just inside the installation boundary where the voltage is reduced so it can be safely distributed to buildings and facilities. Ownership of the electricity transfers from the utility to the military installation at the substation. Once delivered to the substation, the installation becomes responsible for distributing the electricity to end users.

*Id.*

<sup>20</sup> Continuing Appropriations Act of Fiscal Year 1988, Pub.L. No. 100-202, § 8093, 101 Stat. 1329, 1329-79 (1987).

<sup>21</sup> FAR 41.201 (d) and (e).

contractor. First, the installation will award a utility service contract to that contractor for a term of up to fifty years.<sup>22</sup> Second, the installation will sell the particular utility system to the contractor via a bill of sale, concurrent with the signing of the utility service contract. The privatization statute requires that the installation receive fair market value on the sale of the system from the contractor. Third, the installation will grant a right of way to the contractor to allow it to enter the base to operate and maintain its utility system concurrent with the contract action and bill of sale.

Typically, the sale will involve only the utility infrastructure, and not the land surrounding the infrastructure, i.e., the land over, above, under, around the infrastructure.<sup>23</sup> When one says that Base A is “privatizing” its electric utility distribution system, for example, to Utility Company B, that means Base A has agreed to sell its electric system to Company B. Base A has also agreed to enter into a utility service contract with Company B, and to grant a right of way to Company B to allow it to enter the base and operate and maintain its (Company B’s) utility system. The three actions are inextricably entwined and interdependent; an installation would not sell its utility system to a private entity without first reaching an acceptable agreement with that entity to operate and maintain the system for the installation’s benefit. Likewise, a utility company would not purchase a utility system and enter into a contract to provide service without having a right of way to come onto the installation to operate and maintain its utility system.<sup>24</sup>

The terms “regulated utility” and “unregulated utility” are used throughout this article. A “regulated utility company” refers to an entity that is regulated by a state regulatory commission, typically called “public utility commissions” or “public service commissions.” Military installations typically buy their electric power, for example, from an entity that is authorized by the state commission to sell electricity in a defined service

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<sup>22</sup> 10 U.S.C. § 2688(c)(3) (1997); FAR 41.103(b) allows Federal agencies to enter into utility service contracts not exceeding ten years. However, in the National Defense Authorization Act of Fiscal Year 2000, Pub. L. No. 106-65, § 2812, 113 Stat. 774, 851 (2000) [hereinafter “2000 Congressional Amendment”], Congress added para. (3) to subsec. (c) of § 2688, to specifically allow fifty-year utility service contracts for use in privatization actions.

<sup>23</sup> *But see* 10 U.S.C. § 2688(h)(2)(B), added by the 2000 Congressional Amendment, that allows the sale of land, in addition to utility infrastructure, in utility privatization actions.

<sup>24</sup> *See generally* Wells, *supra* note 11.

There will be at least three separate documents required to close the transaction – a bill of sale (for the conveyance of the system as personal property), a real estate document to allow the new owner of the utility system to leave it on or under the government’s real estate ... a service contract to operate the system, and one to supply the product that the utility system will distribute. Note that the supplier and the owner of the distribution system might be the same entity, but also might not be, and even if they are, the transactions will probably be separate.

*Id.*

territory that encompasses the installation. An “unregulated utility company” refers to an entity that is not presently regulated by a state regulatory commission. Unregulated as well as regulated entities compete for award of installation utility privatization contracts. Generally speaking, a regulated utility is concerned with whether its purchase, operation and maintenance of an on-base utility system is permitted by the state body that regulates it, and to what extent its operation of the system must be consistent with state laws and regulations. Unregulated entities do not share these concerns; however, representatives of the regulated utility industry argue that after an unregulated entity purchases an installation’s utility system, that entity must thereafter become subject to state regulation.<sup>25</sup>

### **III. THE DRID NO. 49 DEADLINE TO PRIVATIZE BY 30 SEPTEMBER 2003 IS NOT REALISTIC AND WILL BE EXTENDED**

#### **A. Milestone No. 2 of DRID No. 49 Not Met**

The DoD set an interim goal in DRID No. 49, milestone No. 2, to have all utility privatization solicitations released by 30 September 2001. That is, for all DoD utility systems eligible to be privatized (systems not previously exempted from privatization due to security or economic concerns), the military services were directed to have all solicitations “on the street” by 30 September 2001. None of the services met this goal. As of 12 November 2001, the Army had released only 125 Requests for Proposals (RFPs) out of 294 utility systems available to privatize; the Navy, including the Marine Corps, had released only 397 RFPs out of 722 utility systems available to privatize; and the Air Force had released only 180 RFPs out of 434 utility systems available to privatize.<sup>26</sup> Each service reported higher numbers of solicitation releases in their January 2002 Quarterly Reports, but each still falls well short of the DRID No. 49 goal.<sup>27</sup>

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<sup>25</sup> See, e.g., *Baltimore Gas and Elec. Co. v. United States*, 133 F. Supp. 2d 721 (D. Md. 2001). See discussion *infra* IV.C.

<sup>26</sup> Office of the Secretary of Defense, Energy and Utility Home Page of the Dep’t of Defense Energy and Engineering Directorate (Nov. 12, 2001) <<http://www.acq.osd.mil/installation/utilities/milservice/status.htm>>.

<sup>27</sup> DEP’T OF THE ARMY, DEFENSE REFORM INITIATIVE DIRECTIVE #49, PRIVATIZING UTILITY SYSTEMS, QUARTERLY PROGRESS REPORT (Jan. 15, 2002) (on file with the author) [hereinafter, “DEP’T OF THE ARMY QUARTERLY REPORT”]; DEP’T OF THE NAVY, UTILITIES PRIVATIZATION QUARTERLY REPORT (Jan. 2002) <<https://privatization.nfesc.navy.mil/>> [hereinafter, “DEP’T OF THE NAVY QUARTERLY REPORT”]; DEP’T OF THE AIR FORCE, UTILITIES PRIVATIZATION PROGRAM, FY 02/1 QUARTERLY REPORT (Jan. 15, 2002) (on file with the author). [hereinafter, “DEP’T OF THE AIR FORCE QUARTERLY REPORT”]. In the January 2002 Quarterly Reports, the Army reports that 157 RFPs have been released out of 320 now-available-to-privatize systems. The Navy reports that 444 RFPs have been released out of a now available to privatize 730



## B. What is The Problem?

According to a July 2000 General Accounting Office (GAO) report:

Significant problems are being encountered in privatizing utility systems and the Department is unlikely to meet its goals. As of December 31, 1999, DOD has privatized only 13 of the approximately 1,700 systems it is considering for privatization.... According to DOD officials, privatization efforts are very complex, time consuming, and costly. For example, privatization includes describing the current condition of about 1,700 utility systems, analyzing myriad state and local laws governing utilities, and determining the best value offer received from interested utility companies.<sup>28</sup>

In May 2001, Randall Yim, the DoD Deputy Undersecretary For Installations, reportedly considered “extending a 2003 deadline for privatizing 1,600 utility systems at bases across the country amid industry complaints that the deadline is unrealistic,”<sup>29</sup> but the deadline remained unchanged. Draft utility privatization guidance that DoD has been readying to issue in the near future re-affirmed the 30 September 2003 deadline to privatize all eligible military utility systems,<sup>30</sup> however, most recent indications from DoD are that the deadline will be pushed back a “year or two.”<sup>31</sup> As of 12 November 2001, the Army had awarded twenty utility privatization contracts, the Navy three, and the Air Force none. Therefore, at that time only 14.15% of eligible, available utility systems had been privatized.<sup>32</sup> The number of systems privatized increased slightly by January 2002, as the Army reported twenty-four systems awarded, the Navy still three, and the Air Force, two.<sup>33</sup> The DoD has no doubt taken these figures to heart and it appears will extend the DRID No. 49 deadline of 30 September 2003 to a later date.

Rumblings and uncertainty concerning the wisdom of the 30 September 2003 deadline were evident in the Fall of 2001, specifically, at a 6 September

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systems, and the Air Force reports that 242 RFPs have been released out of a now available to privatize 513 systems.

<sup>28</sup> GEN. ACCT. OFF., REP. NO. GAO/NSIAD-00-72, ACTIONS NEEDED TO SUSTAIN REFORM INITIATIVES AND ACHIEVE GREATER RESULTS (July 2000), at 62.

<sup>29</sup> Tichakorn Hill, *Protests May Delay DoD Utility Privatization*, Federal Times.Com (May 21, 2001) (on file with author).

<sup>30</sup> Draft Policy Guidance, *supra* note 14.

<sup>31</sup> Cahlink, *supra* note 7.

<sup>32</sup> Office of the Secretary of Defense, Energy and Utility Home Page of the Dep’t of Defense Energy and Engineering Directorate, *supra* note 26.

<sup>33</sup> DEP’T OF THE ARMY QUARTERLY REPORT, DEP’T OF THE NAVY QUARTERLY REPORT, DEP’T OF THE AIR FORCE QUARTERLY REPORT, *supra* note 27.

2001 DoD Installations Policy Board (IPB) meeting.<sup>34</sup> The January 2002 Army and Air Force utility privatization Quarterly Reports reference this meeting; the Army understanding of the IPB meeting outcome is that the DRID No. 49 interim milestones have been “deleted,” leaving two options open. Those two options are to either: (1) retain utility system ownership and fund the upgrades necessary to bring them up to standards, or (2) privatize utilities systems to entities better able to upgrade and maintain them.”<sup>35</sup> The January 2002 Air Force Quarterly Report states, “The OSD Installations Policy Board (IPB) meeting held on 6 Sep 01 instructed the services to prepare a utilities revitalization plan without regard to the Defense Reform Initiative Directive (DRID) #49 milestones.”<sup>36</sup> The most recent Navy Quarterly Report does not mention the 6 September 2001 IPB meeting, but discusses a “master plan” representing “the DON’s revised acquisition timeline to show the issuance of RFPs and evaluation of proposals in a phased and balanced approach through 2005.”<sup>37</sup>

In addition to issuing new rules that push back the 2003 deadline by a year or two, the DoD should also either clearly affirm, or deny, the Army’s understanding that privatization is no longer mandatory, but is now one of two “options.” The DoD policy has been to privatize *all* utility systems eligible to be privatized. A system is “eligible to privatize” if not exempted from privatization for security reasons or because it is uneconomical to privatize.<sup>38</sup> However, as a result of the September 2001 DoD IPB meeting, the Army believes that there is now an option to fund the upgrades necessary to bring military utility systems up to standards, *in lieu of privatization*. This is a “third exemption” to utility privatization that has heretofore not existed. Is this the result DoD wants? It should clearly state so, one way or the other.

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<sup>34</sup> The DoD Installations Policy Board is a multi-service working group under The Office of the Secretary of Defense, Installations and Environment. It formulates DoD policy on, among other things, utility privatization.

<sup>35</sup> DEP’T OF THE ARMY QUARTERLY REPORT, *supra* note 27.

OSD deleted the interim milestones of DRID #49 and provided for two options – fund the upgrades necessary to bring utility systems up to C2 standards, or privatize utilities systems to entities better able to improve their condition. The Army will continue to pursue the privatization of utility systems as the preferred course of action and retains the goal to privatize all utility systems by 30 September 2003. Towards that end we have established a goal of 70 privatized systems in this FY and will continue to work to achieve that target.” It is assumed “C2” stands for “Command and Control.

*Id.*

<sup>36</sup> DEP’T OF THE AIR FORCE QUARTERLY REPORT, *supra* note 27.

<sup>37</sup> DEP’T OF THE NAVY QUARTERLY REPORT, *supra* note 27.

<sup>38</sup> DEFENSE REFORM INITIATIVE DIRECTIVE NO. 9, *supra* note 1.

### C. Military Services' Perspectives

An Army forum was conducted on 9 August 2001 with the underlying premise, “[t]he Army’s Utility Privatization Program is broken and needs to be fixed.”<sup>39</sup> That forum concluded that “a. The Program is alive and well; b. The hardest part is generally over and, c. We’ll make the Sep 03 goal.”<sup>40</sup> Following the September 2001 IPB meeting, however, the Army now understands utility privatization to be optional and not mandatory for all eligible systems, but views privatization as the “preferred course of action” and will continue to push towards privatization of all eligible utility systems by 30 September 2003.<sup>41</sup>

In its July 2001 Quarterly Report, the Navy stated “as of 30 June 2001, RFPs have been issued for 398 systems. This represents a 55% completion of Milestone #2.”<sup>42</sup> The DoD statistics discussed above confirm, however, that the Navy did not meet the 30 September 2001 milestone as directed by DRID No. 49.<sup>43</sup> In the “Outstanding Issues” section of its Report, the Navy noted industry concerns as to the reasonableness of the DRID deadlines and recommended (1) that DoD “issue policy that puts a hiatus on requiring the Services to issue further RFPs in order to meet the 30 September 2001 milestone; and (2) develop a joint-service interdisciplinary working group under the Installations Policy Board to make recommendations for program changes.”<sup>44</sup> The January 2002 Navy Quarterly Report stated the Navy had developed a “master detailed plan” which in effect would extend the DRID No. 49 deadline to 2005.<sup>45</sup>

In the summer of 2000, the Air Force instituted what it called the “Utility Privatization Pathfinder Program.” Those bases named as “Pathfinders” would, in effect, serve as the guinea pigs in ferreting out lessons to be learned in how best to privatize utilities in the Air Force. The remaining “Non-Pathfinder” bases have been put on hold, and their solicitations will not be released until an undetermined future date. Out of 434 eligible-to-privatize utility systems, the Air Force has only named 79 as “Pathfinders.” That means 355 Air Force utility systems are eligible to be privatized, but are presently

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<sup>39</sup>Army Facilities and Housing Directorate Home Page (Aug 9, 2001) <<http://www.hqda.army.mil/acsimweb/fd/policy/IPRminutes.htm>>.

<sup>40</sup> *Id.*

<sup>41</sup> DEP’T OF THE ARMY QUARTERLY REPORT, *supra* note 27.

<sup>42</sup> DEP’T OF THE NAVY, UTILITIES PRIVATIZATION QUARTERLY REPORT (July 2001) <<https://privatization.nfesc.navy.mil/>> [hereinafter, “DEP’T OF THE NAVY QUARTERLY REPORT, July 2001”].

<sup>43</sup> Office of the Secretary of Defense, Energy and Utility Home Page of the Dep’t of Defense Energy and Engineering Directorate, *supra* note 26.

<sup>44</sup> DEP’T OF THE NAVY QUARTERLY REPORT (July 2001), *supra* note 42.

<sup>45</sup> DEP’T OF THE NAVY QUARTERLY REPORT, *supra* note 27.

classified as “Non-Pathfinders” and are not on the fast track to privatization.<sup>46</sup> The January 2002 Air Force Quarterly Report discusses the Air Force’s understanding that the 6 September 2001 DoD IPB meeting would ultimately result in new DRID No. 49 milestone dates.<sup>47</sup>

#### D. Congressional Perspective

The U.S. Senate Committee on Armed Services Report accompanying its proposed amendment<sup>48</sup> to 10 U.S.C. § 2688 stated in part:

[S]pecifically, the committee believes that the Department may not be giving potential offerors enough time to respond to its requests for proposals. This particularly affects the utilities required to obtain permission from their regulators in order to form teams or partnerships to respond to the Department’s requirements. Providing insufficient time for regulated entities, therefore, has the effect of limiting competition. The Department should examine and adjust its existing timetables to ensure that potential competitors have adequate time to respond.<sup>49</sup>

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<sup>46</sup> Air Force Civil Engineer Support Agency Home Page (visited Feb. 12, 2002) <http://www.afcesa.af.mil/Directorate/CEO/Contracts/UtilPrivatization/default.htm>.

Air Force leadership is committed to ensuring that funds are available prior to the release of any RFPs and funding issues will continue to be addressed corporately as we gather lessons from the Pathfinders. Seventy-nine systems ... have been approved as Pathfinders. The Pathfinder concept is a sensible and responsible way of proceeding, which allows us to continue to pursue the systems with RFPs on the street and to obtain lessons learned to be used for the rest of the program. Pathfinder projects proving to be economically sound will be awarded while remaining Non-Pathfinder projects can be positioned for release when we have a better understanding of associated privatization costs.

*Id.*

<sup>47</sup> DEP’T OF THE AIR FORCE QUARTERLY REPORT, *supra* note 27. (“The OSD Installations Policy Board (IPB) meeting held on 6 Sep 01 instructed the Services to prepare a utilities revitalization plan without regard to the Defense Reform Initiative Directive (DRID) #49 milestones. The Air Force is preparing its initial plan for submittal to OSD on or about 30 Jan 02. Once approved, new milestone dates will be updated. Until such time, all discussions in this and subsequent Air Force Utilities Privatization (UP) quarterly reports referring to DRID #49 and its milestones are for reference only.”).

<sup>48</sup> H.R. 4205, 106<sup>th</sup> Cong. (2000). Congress considered two amendments to 10 U.S.C. §2688 in 2000; the proposed House amendment would have made utility privatization conveyances and awards subject to state law, and would also have subjected the contractor selected to state laws and regulations. The proposed Senate amendment, S.2551, 106<sup>th</sup> Cong. (2000), did not contain such broad concessions to state law applicability, but rather said that non-competitive procurement procedures could be used in accordance with 10 U.S.C. § 2304 (c) through (f). The 2000 Amendment passed by Congress was most similar to the Senate’s proposed amendment.

<sup>49</sup> S. REP. NO. 106-292, to accompany S. 2549, 106<sup>th</sup> Cong. (2000).

## E. Where Are We?

The Senate Committee on Armed Services Report excerpt above shows that some members of the Senate, at least, are not pushing any sort of timetable upon DoD within which to accomplish utility privatization. There certainly is no legal authority mandating that utility privatization in the military be accomplished by a certain date, and in fact, there is a sense from Congress to slow down and make sure the timetables give potential offerors the opportunity to properly respond.

The Air Force's Pathfinder Program is based upon the premise that utility privatization will be done the right way. The Air Force will take the time to form lessons learned, and then apply those lessons to Non-Pathfinder solicitations. However, it seems unlikely that taking such a measured, common-sense approach will lead the Air Force to meeting a 30 September 2003 deadline to privatize all eligible systems. In fact, the 30 September 2003 DoD deadline will likely not be met by any of the services. The deadline should be extended to allow the release of well-crafted RFPs, and to allow potential offerors enough time to submit worthwhile proposals. The sense of the Senate<sup>50</sup> is correct, and there is no reason to impose unreasonable artificial deadlines. This is a message apparently "received" at DoD and the deadline is expected to be extended.<sup>51</sup>

Further, DoD needs to clarify the outcome of the 6 September 2001 IPB meeting. The Army understands that privatization of all eligible systems is no longer required, and that a new option to fund system upgrades and retain ownership now exists. Is the Army correct? Is the current DoD policy that installations do not have to privatize their eligible utility systems, but if they do privatize, they have to do so within the DRID No. 49 timeline or within extended deadlines? If so, this is a major and welcome shift in policy.

## IV. THE ROLE OF STATE LAWS AND REGULATIONS IN UTILITY PRIVATIZATION

One area meriting careful DoD evaluation is state law interaction with utility privatization implementation. Generally speaking, it appears that state law has neither authority over the utility privatization solicitation process, nor over the contractors selected in the solicitation process. However, state regulation has benefits that DoD may want to take advantage of, and indeed, the current Army and Air Force solicitation templates give state regulatory bodies significant authority over the installations' relationship with the utility privatization contractor.

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<sup>50</sup> *Id.*

<sup>51</sup> Cahlink, *supra* note 7.

## A. The Issues

Two main issues exist regarding the interface between state law and utility privatization. The first issue concerns whether state laws and regulations apply to the conveyance of an on-base utility system to a private entity under 10 U.S.C. § 2688. In other words, does state law have any effect on either the solicitation process or on a military installation's selection of a utility privatization contractor? Regulated utility companies (companies regulated by state public utility commissions)<sup>52</sup> have argued that because state commission-set service territories encompass the privatizing military installation, state law therefore mandates that the installation award its utility privatization project to the regulated utility on a sole source basis. This position has been rejected by DoD and has not been supported by either the GAO or the Maryland Federal District Court that reviewed the issue.<sup>53</sup>

The second issue concerns state regulation of utility privatization contractors. Does state law have any impact on the relationship between a military installation and the utility privatization contractor that the installation selects to own, operate and maintain the on-base utility distribution system? Do state public utility commissions have any jurisdiction over the utility privatization contractor, especially if the contractor selected is a "regulated utility?"

A third, and much more interesting issue is whether, regardless of what the law strictly requires, DoD should nevertheless *desire* state regulation of its relationships with its utility privatization contractors. Indeed, and in seeming contravention of a DoD General Counsel (DoD/GC) opinion,<sup>54</sup> the current Army and Air Force utility privatization solicitation templates include provisions that would require military installations to pay utility rates set by a state regulatory commission, perhaps the strongest form of state regulation.

## B. DoD Position

### 1. DoD/GC 24 February 2000 Opinion

The General Counsel of the Department of Defense (DoD/GC) issued an opinion on "The Role of State Laws and Regulations in Utility Privatization" on 24 February 2000.<sup>55</sup> This "opinion" has no precedential

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<sup>52</sup> See discussion *supra* section IV.D regarding "regulated utility companies" and "unregulated utility companies."

<sup>53</sup> See *infra* notes 66, 73.

<sup>54</sup> See *infra* note 55.

<sup>55</sup> Memorandum, The General Counsel of the Dep't of Defense, to the General Counsel of the Army, the General Counsel of the Navy, and the General Counsel of the Air Force, subject: The Role of State Laws and Regulations in Utility Privatization (24 Feb. 2000) <<http://www.acq.osd.mil/installation/utilities/policies/policies.htm>>.

value but one assumes the military services are expected to follow it. The opinion concludes that state law is not applicable to the conveyance of on-base utility systems under 10 U.S.C. § 2688. Federal installations are to conduct utility privatization solicitations competitively, as required by Section 2688, regardless of whether state law application might result in a sole-source award to a specified utility company.<sup>56</sup> Further, the opinion reads, “[t]he state may not regulate the Federal Government’s acquisition of utility services related to the on-base utility system. Federal procurement laws and regulations are supreme in this area.”<sup>57</sup>

The practical effect of DoD/GC’s opinion is that military installations pursuing utility privatization projects must conduct their solicitations competitively in accordance with 10 U.S.C. § 2688, without regard to any conflicting state law that might prohibit competitive solicitations. Further, once the utility privatization contractor is competitively selected, that contractor’s relationship with the installation will not be regulated by the state.

## 2. Caveats to DoD/GC Opinion

### a. Limited State Regulation Permitted

The DoD/GC opinion leaves room for some level of state regulation of a utility privatization contractor. Pervasive state regulation, especially that which would overturn an installation’s competitive selection of a contractor, is not permitted. However, certain state regulations and laws regarding the contractor’s operation of the on-base system may have to be complied with, if they do not impose a significant burden on the federal government.<sup>58</sup>

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Because Congress has not waived the sovereign immunity of the United States with respect to the conveyance of an on-base utility system under section 2688 of title 10, United States Code, state law is not applicable to the conveyance of an on-base utility system under Section 2688; rather, Section 2688 governs the conveyance. Accordingly, ‘[i]f more than one utility or entity ... notifies the Secretary concerned of an interest in a conveyance ..., the Secretary shall carry out the conveyance through the use of competitive procedures’, not on a sole source basis to a utility that state law indicates has an exclusive right to provide utility service in the relevant geographic area.

*Id.* at 4.

<sup>57</sup> *Id.* at 8, 9.

<sup>58</sup>

[w]hile the entity to whom the Department conveyed the on-base system is not required to submit to state licensing or similar requirements that undermine the Federal competitive selection of that entity, to the extent the state has regulations regarding the conduct of operation and ownership of utility systems, the entity may have to comply with those requirements if those state requirements do not impose a significant burden on the Federal Government, conflict with a Federal system of

The DoD/GC opinion explains that in some instances, state regulators have used what could be called a back-door approach to regulating contractors on federal installations. The result is often a conflict between Federal regulations affecting Federal purchases and state regulation of providers of goods and services in its territory. Typically, states will require a provider of a particular service or item of supply to be licensed while Federal contracting rules do not require the vendor to obtain a state license.<sup>59</sup>

One can envision a utility privatization scenario in which a state utility regulatory commission would not aggressively insert itself into, or actively oppose, the competitive solicitation process. The state commission in this scenario would not necessarily maintain that it had the authority to tell a military installation how to conduct its utility privatization solicitation and would not pointedly direct the sole-source selection of a particular utility company as the utility privatization contractor. However, if the state commission required the utility privatization contractor to possess a state license issued by the commission, then the state regulatory licensing procedure would interfere with the federal contractor selection process. Additionally, if the state commission would only give a license to the utility company granted the particular state commission-set service territory encompassing the military installation, then of course the state regulator would be indirectly and improperly interfering with the federal selection process.

The DoD/GC opinion resolves the conflict between state and federal law through a Constitutional Supremacy Clause analysis.”<sup>60</sup> The opinion cites *California Fed. Savings & Loan Ass’n v. Guerra* for the proposition that “[C]ongressional intent to pre-empt state law in a particular area may be inferred where the scheme of federal regulation is sufficiently comprehensive to make reasonable the inference that Congress ‘left no room’ for supplementary state regulation.”<sup>61</sup>

In DoD/GC’s view, while these Constitutional principles prevent a state from requiring a military installation’s utility privatization contractor to obtain a state license, they do not shut out all forms of state regulation. The opinion recognizes that, by and large, on-base utility distribution systems are interconnected with larger off-base systems. The well-being of the entire

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regulation, or undermine the Federal policy being implemented. This will require a careful analysis of particular state requirements in relation to the Federal action.

*Id.* at 9.

<sup>59</sup> *Id.* at 6.

<sup>60</sup> U.S. CONST., art. VI, cl. 2, *cited in* Memorandum, The General Counsel of the Dep’t of Defense, *supra* note 55. (The Supremacy Clause states, “This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land; and the Judges in every state shall be bound thereby, any Thing in the Constitution or Laws of any state to the Contrary notwithstanding.”).

<sup>61</sup> *California Fed. Savings & Loan Ass’n v. Guerra*, 479 U.S. 272, 284 (1987), *cited in* Memorandum, The General Counsel of the Dep’t of Defense, *supra* note 55.



system, in essence, depends in part upon the proper operation of the on-base portion of the system. Therefore, DoD/GC recognizes that installations should follow some state-imposed safety and health regulations that affect the entire utility system.<sup>62</sup>

The DoD/GC, therefore, envisions some level of permissible state regulation of the utility privatization contractor. The issue that will be discussed later<sup>63</sup> is whether the DoD/GC opinion's "permissible level of state regulation" would include a federal installation's payment of state commission-set utility rates to a utility privatization contractor that is regulated by the state.

*b. "Section 8093"*

Section 8093 of Fiscal Year 1988 DoD Appropriations Act requires federal agencies to purchase electricity in a manner consistent with state law, including compliance with state utility commission rulings and electric utility franchises or service territories established pursuant to state law.<sup>64</sup> However,

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States may justify regulation of a utility contractor on other grounds e.g. safety and health considerations affecting the broader utility distribution framework. This requires a different Supremacy Clause analysis since it is not the case that Congress has 'left no room' for state regulation to ensure safe and economical operation of intrastate utility distribution systems.... Given potentially inconsistent Federal and state regulations each addressing legitimate concerns, a balancing test is required.... In applying a balancing test, the Courts would be required to balance Federal policies favoring maximum possible competition in government contracting against whatever safety or other regulatory concerns the states could articulate. It would seem clear from the case law that the state could not impose a license requirement because that could operate to overturn the Federal selection of a contractor using competitive procedures.... However, the state may well regulate the operation of that contractor in a non-discriminatory way to protect the health and safety of all its citizens as long as that regulation does not impose a significant burden on the Federal government or conflict with a Federal system of regulation.... *North Dakota v. United States*, 495 U.S. 423 (1990). Some degree of state regulation of the contractor operating a utility system on the installation may be permissible, to ensure, for example, that the operation of the on-base system does not threaten the safety and reliability of any utility system to which the on-base system connects.

Memorandum, The General Counsel of the Dep't of Defense, *supra* note 55, at 7, 8.

<sup>63</sup> See discussion *infra* section IV.D.3.

<sup>64</sup> Continuing Appropriations Act of Fiscal Year 1988, Pub.L. 100-202, § 8093, 101 Stat. 1329 (1987).

None of the funds appropriated or made available by this or any other Act with respect to any fiscal year may be used by any Department, agency, or instrumentality of the United States to purchase electricity in

the 24 February 2000 DoD/GC opinion narrowly construed this statute such that only the electricity commodity must be purchased in accordance with state law.<sup>65</sup> Utility privatization does not include the purchase of the electricity commodity, but rather, involves the conveyance of on-base electric distribution systems to private entities that will then own, operate and maintain the electric systems. The installation will continue to purchase its electricity from the local provider, in accordance with state law (in those states that have not deregulated their electric industry).

### **C. GAO and Maryland Federal District Court Decisions Support DoD/GC Position**

In *Virginia Electric and Power Company (VEPCO); Baltimore Gas & Electric Company (BG&E)*,<sup>66</sup> two regulated utility companies protested the competitive solicitation issued by the Army Corp of Engineers for the privatization of utilities at five installations in the National Capital Region under the Military District of Washington (MDW).<sup>67</sup> The VEPCO and BG&E contended the solicitation was improper because it failed “to recognize that the privatization of the utilities is subject to state and local utility law and regulation.”<sup>68</sup>

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a manner inconsistent with State law governing the provision of electric utility service, including State utility commission rulings and electric utility franchises or service territories established pursuant to State statute, State regulation, or State-approved territorial agreements.

*Id.* Section 8093 only applies to the electricity commodity, and does not apply to any other utility commodities.

<sup>65</sup> Memorandum, The General Counsel of the Dep’t of Defense, *supra* note 55, at 5.

A plain reading of Section 8093’s operative statutory language ... necessarily leads to the conclusion that the waiver of sovereign immunity in that section is limited to purchase of the electric commodity (electric power) excluding distribution or transmission services. There is nothing in this section to indicate that ‘purchase electricity’ should be read in any way other than its plain language. Consequently, electricity does not include the provision of utility services other than the commodity itself.

*Id.*

<sup>66</sup> *Virginia Elec. and Power Co.; Baltimore Gas & Elec. Co., Comp. Gen. B-285209, B-285209.2*, Aug. 2, 2000, 2000 CPD ¶134.

<sup>67</sup> *Id.*

<sup>68</sup>

BG&E asserts that it is the only entity authorized by Maryland law and the Public Service Commission of Maryland (PSC) to own, operate and maintain electric and natural gas distribution systems in the Fort Meade area. According to BG&E, before any other entity can perform the utility privatization requirements for electric and natural gas distribution services at Fort Meade, that entity must first obtain an electric franchise and right to operate from the Maryland state legislature, as well as revision by the PSC of

The GAO denied the protest, deciding that 10 U.S.C. § 2688 preempted state law.<sup>69</sup> The GAO noted that “the effect of the protesters’ argument would be that the contracts for electric and gas distribution would be awarded on a sole-source basis to the company holding the local utility franchise at each installation,”<sup>70</sup> an impermissible effect in the GAO’s view.<sup>71</sup> The GAO rejected the protester’s argument that Section 8093 required compliance with state law dictating the utility privatization contractor selection process, instead following the DoD/GC opinion’s narrow construction of Section 8093.<sup>72</sup> The BG&E disagreed with GAO’s decision and filed suit in Maryland Federal District Court.<sup>73</sup> The District Court concurred with the GAO opinion, holding that 10 U.S.C. § 2688 clearly required the use of competitive procedures in selecting utility privatization contractors, even if this procedure conflicted with state law and regulations.<sup>74</sup> In the court proceedings, BG&E’s focus shifted somewhat from attacking the solicitation procedure to attacking the post-award status of the successful offeror. The BG&E argued to the federal court that DoD’s solicitation was illegal because it did “not specify that the PSC will have jurisdiction over the successful bidder that becomes the new owner of the Fort Meade utility distribution system,”<sup>75</sup> and also because the “[s]olicitation does not require that a bidder hold franchise rights and a utility license issued by the PSC.”<sup>76</sup>

In the federal court case, BG&E argued again that Section 8093 required federal agencies, including military installations, to adhere to state commission-service territories when awarding utility privatization contracts. The court, however, agreed with the GAO’s observation that the effect of accepting BG&E’s argument “would be that the contracts for electric and natural gas distribution would be awarded on a sole-source basis to the company holding the local utility franchise,”<sup>77</sup> an effect neither the GAO nor the Maryland Federal District Court was willing to adopt. The Court found that “in the October 2000 amendments to Section 2688, Congress expressly prohibited the application of state public utility law to curtail competitive

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its order designating BG&E as the sole entity responsible for electric service in the Fort Meade area, and obtain a gas franchise from Anne Arundel County, Maryland, and the consent of local authorities and the PSC to exercise the gas franchise.

*Id.* at 8 - 9.

<sup>69</sup> *Id.*

<sup>70</sup> *Id.*

<sup>71</sup> *Id.*

<sup>72</sup> *Id.*

<sup>73</sup> *Baltimore Gas and Elec. Co. v. United States*, 133 F. Supp. 2d 721 (D. Md. 2001).

<sup>74</sup> *Id.* at 739.

<sup>75</sup> *Id.* at 724. “PSC” stands for “Public Service Commission.”

<sup>76</sup> *Id.* at 724.

<sup>77</sup> *Id.* at 734.

bidding for any of the Army's privatization contracts.”<sup>78</sup> The Court held that 10 U.S.C. § 2688 preempted any state public utility laws that precluded competition.<sup>79</sup>

**D. Even if the Federal Government is Not Legally Required to Accept State Jurisdiction Over the Utility Privatization Contractor, Should It Nevertheless Desire State Jurisdiction? Moreover, Do the Army and Air Force RFP Templates Actually Promote State Jurisdiction?**

Although both GAO and the Maryland court upheld DoD's position on state regulatory authority, some, particularly those representing national associations of regulated utility companies, argue DoD is foolish to not desire the many benefits that state regulation has to offer. In effect, they argue, why should DoD pay to police and monitor the utility privatization contractor with government personnel, when DoD can receive the benefits of state regulation for free?

*1. Arguments in Favor of State Regulation/Jurisdiction*

The regulated utility industry lobbied Congress heavily in 2000 to enact an amendment proposed in the U.S. House of Representatives that would have required DoD installations to comply with state law in their implementation of utility privatization projects.<sup>80</sup> They believed the House amendment would likely result in utility privatization sole-source awards to regulated local utility providers because most states have delineated service territories. In fact, the Court in the *BG&E* case noted that had the House amendment passed, the result in the case would have been different, and a decision in favor of BG&E would have been required.<sup>81</sup> The House amendment did not pass; instead, Congress passed an amendment that reaffirmed the competitive solicitation process but also contained language requiring the utility privatization process to be conducted in a manner consistent with state laws to the extent necessary to ensure all interested regulated and unregulated utility companies and other interested entities receive a fair opportunity to compete for awards.<sup>82</sup>

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<sup>78</sup> *Id.* at 739.

<sup>79</sup> *Id.* at 745.

<sup>80</sup> H.R. 4205, 106<sup>th</sup> Cong. (2000).

<sup>81</sup> *Baltimore Gas & Elec. Co.*, 133 F. Supp. 2d at 739.

<sup>82</sup> 10 U.S.C. § 2688 (1997). As the statute itself says,

With respect to the solicitation process used in connection with the conveyance of a utility system (or part of a utility system) under subsection (a), the Secretary concerned shall ensure that the process is conducted in a manner consistent with the laws and regulations of the State in which the utility system is located to the extent necessary to ensure that all interested regulated and unregulated utility companies

Arguments made by the American Public Power Association (APPA) to Congress in 2000 were typical of those made by the regulated utility industry in favor of the proposed House amendment to Section 2688 to mandate adherence to state law.<sup>83</sup> The APPA identified three potentially problematic and costly aspects of selling the utility systems and awarding long-term utility service contracts to unregulated entities. The APPA argued that unregulated entities were more likely to default on utility privatization service contracts than regulated entities, creating a future estimated \$2 to \$3 billion liability on the part of DoD.<sup>84</sup> The second problem they identified dealt with the “bargaining leverage” that an unregulated entity would hold at the end of the initial fifty-year utility privatization service contract.<sup>85</sup> The APPA reasoned to Congress that at the end of the fifty-year service contract, an installation would have no choice but to accept contract terms and prices, unreasonable or otherwise, proposed by the unregulated owner of the utility system since the installation was in effect the “captive customer” of the contractor.<sup>86</sup> The installation would be unable to select a different contractor, because the system owner would not be required to let another entity operate and maintain its property. The third argument made by the APPA pointed to the high cost DoD would incur in monitoring the contract performance of unregulated contractors. The regulated utility industry argued that it could provide effective, efficient regulatory oversight of regulated utilities selected as privatization contractors.<sup>87</sup>

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and other interested entities receive an opportunity to acquire and operate the utility system to be conveyed.

*Id.* Subsection (f)(2) states, “The Secretary concerned shall require in any contract for the conveyance of a utility system (or part of a utility system) under subsection (a) that the conveyee manage and operate the utility system in a manner consistent with applicable Federal and State regulations pertaining to health, safety, fire, and environmental requirements.”

<sup>83</sup> Memorandum from the American Public Power Association, prepared by Talisman Partners, Ltd., to Congress (April 26, 2000) (on file with author) [hereinafter “APPA memorandum”].

<sup>84</sup> *Id.* (“DoD costs of recovering a utility distribution system upon the default, abandonment, or early contract termination by an unregulated owner are expected to be in the range of \$2.2 to \$3.3 billion during the initial expected 50-year term of DoD utility privatization contracts.”).

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DoD costs associated with the bargaining leverage held by the unregulated utility owner at the end of the initial contract when negotiating a new contract for continued service could total \$34 to \$147 billion over the 50-year period following the initial contract period.... This bargaining leverage directly results from the DoD installation becoming a captive customer of the unregulated entity, and the unregulated entity having no legal or practical restrictions on the pricing of services in the follow-on contract. This circumstance is exclusively attributable to the lack of regulation or public oversight. *Id.*

<sup>86</sup> *Id.*

<sup>87</sup>

DoD costs of providing needed oversight that would typically be provided by a regulatory body could total \$2.1 to \$2.4 billion during the

In July 2000, Colorado Springs Utilities (CSU) joined in the Congressional lobbying effort, arguing for passage of the proposed House amendment to 10 U.S.C. § 2688. Their lawyers provided a case study of the Air Force's effort to privatize the natural gas distribution system at Mather AFB, California, and the difficulties encountered due to the unregulated status of the utility privatization contractor. The CSU's letter to Congress stated in part, "This 'real world' experience with a defaulting utility privatization company underscores why Congress needs to extend State utility law to utility privatization companies that ultimately will own and operate the retail utility distribution systems on DoD installations."<sup>88</sup> The CSU letter to Congress criticized DoD's policy of contractual enforcement of state utility system standards and practices. They argued that not only was DoD foolishly failing to rely upon the expertise and experience of state regulators, but also that DoD possessed "no effective enforcement mechanism."<sup>89</sup>

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50-year contract period. These costs represent the added DoD expense related to assuring periodic price re-determinations are at fair and reasonable levels, and enforcement of safety requirements, industry standards, as well as other matters for the common good. These regulatory oversight functions must be provided for by the DoD or ignored for services rendered by a provider that is not subject to utility commission regulation or other public oversight and control.

*Id.*

<sup>88</sup> Letter from Timothy B. Mills, Counsel for Colorado Springs Utilities, to George W. Lauffer, Professional Staff Member, Senate Armed Services Committee (July 18, 2000) (on file with author).

<sup>89</sup>

The natural gas utilities privatization company defaulted on its contractual obligations to the Air Force and its legal obligations owed under California State utility law and the rulings and regulations of the California Public Utilities Commission (California PUC) to maintain and operate a safe and reliable distribution system.... Even though the Air Force's contractual agreement with the utilities privatization company obligated the private company to operate the Mather Field natural gas distribution system in accordance with the requirements of State utility law, including, but not limited to, safety and environmental requirements – as is the case with DoD's proposed utility privatization contracts – the Air Force possessed no effective enforcement mechanism. ... DoD claims that it intends to make the requirements of State utility laws, regulations, standards and practices applicable to utilities privatization companies by including these requirements as material terms and conditions of the DoD utilities privatization contracts. Thus, DoD inexplicably and unnecessarily places itself in the incongruous position of (a) on the one hand, imposing State utility laws, regulations, standards and practices on the privatization company as contract requirements, while (b) on the other hand, insisting at the same time that exclusive federal legislative jurisdiction and 'sovereign immunity' should be maintained so that the State utility law regulators most expert in such laws, regulations, standards and practices, should

The regulated industry message to DoD and to Congress seemed to be, do not ask for freedom from state regulation, because you might get it. They argued that DoD was being shortsighted by not taking advantage of state regulatory oversight already in place. They further argued that a regulated utility serving an installation in the capacity of a utility privatization contractor would, by virtue of its regulated status, have an obligation to serve the base, independent of and in addition to its contractual obligations.

Interestingly, language from the 2000 Senate Armed Services Committee Report accompanying its proposed amendment to Section 2688<sup>90</sup> supports the regulated industry's arguments:

While the committee supports the Department's competitive privatization efforts, it believes that the Department must be mindful of the impacts of these efforts upon public safety and the public interest in assuming a safe and effective network of utility systems among multiple users. The Department should take steps, either through reliance upon existing public utility regulatory mechanisms or through careful contract provisions and service oversight of privatization contracts, to protect public interests both within and without base installation boundaries.<sup>91</sup>

The Senate expressly stated that taking advantage of "existing public utility regulatory mechanisms" might be a good idea. This view would seem to support the conclusion that if an installation selects a regulated utility as its privatization contractor, then the installation could accept jurisdiction of the state utility regulatory body. Conversely, if an unregulated entity were selected, the installation would have to rely upon "careful contract provisions and service oversight of privatization contracts."<sup>92</sup>

Further, DRID No. 49 justified the utility privatization initiative as primarily an effort to get DoD out of the utility business and focus on core competencies.<sup>93</sup> Accepting state utility commission jurisdiction over the utility privatization contractor seems more in line with this sentiment, rather than policing and heavy monitoring of the contractor solely with federal government personnel, which does not lend itself to "getting out of the utility business."

Both the current Army and Air Force utility privatization RFP templates include, as a contract clause, Change in Rates or Terms and Conditions of Service for Regulated Services.<sup>94</sup> The section below will discuss what the effect of this clause is, and whether its inclusion in the RFP is

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have no power or authority to enforce these requirements, even if requested by DoD.

*Id.*

<sup>90</sup> S. 2551, 106<sup>th</sup> Cong. (2000).

<sup>91</sup> S. REP. NO. 106-292, *supra* note 49.

<sup>92</sup> *Id.*

<sup>93</sup> DEFENSE REFORM INITIATIVE DIRECTIVE NO. 49, *supra* note 2.

<sup>94</sup> FAR 52.241-7.

consistent with the current DoD utility privatization policy stated in the 24 February 2000 DoD/GC opinion.

## 2. *The “Regulated Rates” Clause*

The Regulated Rates clause, FAR 52.241-7,<sup>95</sup> requires the government to automatically pay utility rate increases approved by statewide utility regulatory bodies and to incorporate the rate increases via utility service contract modifications. A military installation affected by a rate increase may object to the increase, but, like any other utility customer, it accepts the jurisdiction of the state public utility commission to rule on its objection. This clause reflects DoD policy to “comply with the current regulations, practices and decisions of independent regulatory bodies which are subject to judicial appeal.... Rates established by an independent regulatory body are considered ‘prices set by law or regulation’ and do not require submission of cost or

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Change in Rates or Terms and Conditions of Service for Regulated Services (Feb. 1995). (a) This clause applies to the extent services furnished under this contract are subject to regulation by a regulatory body. The contractor agrees to give \* \_\_\_\_\_ written notice of (1) the filing of an application for change in rates or terms and conditions of service concurrently with the filing of the application and (2) any changes pending with the regulatory body as of the date of contract award. Such notice shall fully describe the proposed change. If, during the term of this contract, the regulatory body having jurisdiction approves any changes, the Contractor shall forward to the Contracting Officer a copy of such changes within 15 days after the effective date thereof. The Contractor agrees to continue furnishing service under this Contract in accordance with the amended tariff, and the Government agrees to pay for such service at the higher or lower rates as of the date when such rates are made effective. (b) The Contractor agrees that throughout the life of this contract the applicable published and unpublished rate schedule(s) shall not be in excess of the lowest cost published and unpublished rate schedule(s) available to any other customers of the same class under similar conditions of use and service. (c) In the event that the regulatory body promulgates any regulation concerning matters other than rates which affects this contract, the Contractor shall immediately provide a copy to the Contracting Officer. The Government shall not be bound to accept any new regulation inconsistent with Federal laws or regulations. (d) Any changes to rates or terms and conditions of service shall be made a part of this contract by the issuance of a contract modification unless otherwise specified in the contract. The effective date of the change shall be the effective date by the regulatory body. Any factors not governed by the regulatory body will have an effective date as agreed to by the parties.

FAR 52.241-7.



pricing data....”<sup>96</sup> In a typical scenario, Base A purchases its electric power from Utility Company B, the “local provider” authorized by the state public utility commission to provide service in the territorial area encompassing Base A. If Utility Company B’s rates, terms, and conditions of service are set and regulated by an independent statewide regulatory body, then DoD procurement policy is to accept, as a matter of comity, the decisions of that regulatory body relative to rate increases, for example, reserving the right to object to a rate increase, but ultimately accepting the jurisdiction of the state commission to decide the case.

The DoD procurement policy set out in DFARS 241.201 and the Regulated Rates clause pre-date the DoD utility privatization initiative.<sup>97</sup> In fact, it is not likely that utility privatization was envisioned when these provisions were drafted. The distinction is important. In a pre-privatization scenario, a utility company provided service (gas, electric) to the base boundary. The utility company transported the commodity to the base. Using electric distribution as an example, the commodity (the electricity) was transferred from the utility company system to the base distribution system, and then distributed throughout the base, over a base-owned electric distribution system. In this pre-privatization scenario, where the installation still owns and operates the on-base utility distribution system, the present effect of the FAR Regulated Rates clause is that the installation agrees to pay rates set by the state utility regulatory body for the commodity that is delivered to them and for utility company charges ancillary to delivery of the commodity to the base gates. The base agrees to abide by terms of service set by the state regulatory body.

Presently, however, in a pre-privatization scenario, the state regulatory body is only exercising jurisdiction over off-base activities. The rates that state utility commissions set, that must be paid by military installations, reflect the

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Except as provided in FAR 41.201, DoD, as a matter of comity, will comply with the current regulations, practices, and decisions of independent regulatory bodies which are subject to judicial appeal. This policy does not extend to regulatory bodies whose decisions are not subject to appeal nor does it extend to nonindependent regulatory bodies. (2) Purchases of utility services outside of the United States may use – (i) Formats and technical provisions consistent with local practice; and (ii) Dual language forms and contracts. (3) Rates established by an independent regulatory body are considered ‘prices set by law or regulation’ and do not require submission of cost or pricing data (see FAR Subpart 15.4).

DFARS 241.201.

<sup>97</sup> DEFENSE REFORM INITIATIVE DIRECTIVE NO. 9 announced the DoD utility privatization initiative in December 1997. The most recent version of the Regulated Rates clause, FAR 52-241-7, is dated February 1995. DFARS 241.201 was most recently revised in January 2000, but its language is substantially the same as it was prior to 1997.

cost of delivering the particular commodity involved to the “base gates.” This transportation of commodity occurs off the installation. The state regulatory bodies, the public utility commissions, do not presently have any jurisdiction over military installations’ operation of their on-base utility distribution systems, nor have they ever. Will that change once an installation privatizes its system to a private entity? In the event a base privatizes to an unregulated entity, then that scenario will not change. But what happens if the base sells its electric system to a utility company regulated by the state public utility commission? As will be discussed below, the DoD response to this question is mixed and inconsistent.

### *3. What Exactly is the DoD Policy on Pervasive State Regulation of the Utility Privatization Contractor?*

The Army successfully argued in the *BG&E* case<sup>98</sup> that the Maryland Public Service Commission (PSC) would not have jurisdiction over the utility privatization contractor it selected; that the Army had, as a matter of comity, agreed to require the private contractor to be bound by state and local health, safety and environmental laws, including utilities laws and regulations; that the PSC would not have regulatory jurisdiction over the private entity that obtained the contract or otherwise have authority to enforce those state and local standards; that the Army would enforce those standards, having extensive provisions in the solicitation requiring the contractor to enable that enforcement.

In favorably ruling on these arguments, the *BG&E* Court held that the

the federal government has absorbed state law, including utilities law, to supply the regulatory standards necessary and appropriate for the operation and maintenance of the electricity and natural gas distribution systems at Fort Meade; however, it has not agreed to the PSC’s exercise of jurisdiction for the enforcement of those standards. Instead, the federal government will continue to enforce those standards even after the systems are transferred to private hands.<sup>99</sup>

This is exactly the modus operandi that Colorado Springs Utilities questioned in its letter to Congress, supporting the proposed House amendment to Section 2688.<sup>100</sup> Why should DoD “adopt” state regulations and standards if DoD is going to inexpertly “enforce” them itself, rather than take advantage of the in-place, built-in regulatory oversight provided by the state commissions to provide enforcement?

A review of both the Army and Air Force utility privatization templates reveals that the regulated utilities may have their wish after all. In seeming

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<sup>98</sup> *Baltimore Gas & Elec. Co.*, 133 F. Supp. 2d at 739.

<sup>99</sup> *Id.* at 738.

<sup>100</sup> Letter from Timothy B. Mills to George W. Lauffer, *supra* note 88.

contravention of the Army's position in the *BG&E* case<sup>101</sup> and the DoD/GC opinion,<sup>102</sup> both RFP templates contain FAR 52.241-7, the Regulated Rates clause.<sup>103</sup> Inclusion of this clause in a utility service contract between an installation and a utility privatization contractor will give state public utility commissions the authority to set the utility rate to be paid by the installation, as well as other terms and conditions of service.

The DoD/GC opinion did allow for some degree of state regulation of the utility privatization contractor, generally in the area of health and safety concerns. This concession of some state regulatory authority, however, does not appear broad enough to permit state regulation over the rate to be paid by the installation to the contractor or to terms and conditions of service other than those safety and health-related.

There is obviously a disconnect in DoD policy in this area. On the one hand are the principles set out in the 24 February 2000 DoD/GC opinion, which were consistent with the position taken by the Army in the *BG&E* case. The position taken by DoD was that, with a few caveats, state law and regulations had no effect in the relationship between an installation and its utility privatization contractor. However, the Army and Air Force RFP templates permit a great deal of state regulatory control over the relationship between the installation and the contractor. What can be more pervasive in terms of regulatory oversight than the setting of the rate the installation will pay to the contractor? Yet that is precisely what the Army and Air Force RFP templates allow by inclusion of the Regulated Rates clause, FAR 52.241-7.

A potential offeror in the Texas Regional Demonstration (TRD) noted this very incongruity in a Question and Answer session, asking if the government had determined whether the privatized electric or natural gas service would be subject to state regulatory jurisdiction.<sup>104</sup> The government responded that federal law governed the privatization actions.<sup>105</sup> The potential offeror also asked if the federal government believed state jurisdiction was not applicable to "reconcile this determination with the Clause I.5 which provides for regulated utility FAR provisions."<sup>106</sup> Clause I.5 of the TRD solicitation, as

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<sup>101</sup> *Baltimore Gas & Elec. Co.*, 133 F. Supp. 2d at 721.

<sup>102</sup> Memorandum, The General Counsel of the Dep't of Defense, *supra* note 55.

<sup>103</sup> AIR FORCE RFP TEMPLATE; ARMY RFP TEMPLATE, *supra* note 18.

<sup>104</sup> DEFENSE ENERGY SUPPORT CENTER, TEXAS REGIONAL DEMONSTRATION SOLICITATION, AMENDMENT 3, QUESTION 78C (March 13, 2000) <<http://www.desc.dla.mil/PublicPages/a/priv/TRD/Amd3.pdf>> The potential offeror asked, "Has the DESC made a determination that privatized electric or natural gas service is subject to the jurisdiction of any of the regulatory bodies: the Public Utility Commission of Texas (PUCT), the Texas Railroad Commission (TRRC), or the City Counsel of the City of San Antonio in the case of Lackland AFB and Randolph AFB?" The "Texas Regional Demonstration" is a solicitation released by the Defense Energy Support Center (DESC) for the privatization of the natural gas, electrical, water and wastewater utility infrastructure at nine military installations located throughout the State of Texas.

<sup>105</sup> *Id.*

<sup>106</sup> *Id.*

well as the Army and Air Force utility privatization RFP templates, incorporates the Regulated Rates clause into the contract. The potential offeror asked a very good question. If the government is saying that privatized electric and natural gas service is not subject to the jurisdiction of the state regulatory commission, why is the Regulated Rates clause contained in the RFP?

It would seem that the regulated utility companies have won a limited victory from their perspective. It is true that these companies were unsuccessful in their efforts to lobby Congress to pass the proposed House amendment to 10 U.S.C. § 2688.<sup>107</sup> This amendment would have required compliance with state law, and virtually assured award of utility privatization projects to the regulated “local utility” on a sole-source basis. However, should a regulated utility win a utility privatization competitive solicitation, then the service contract it will sign with the awarding installation will include the FAR Regulated Rates clause which provides for the state regulatory commission to set the rate, terms and conditions of service.

Inclusion of the Regulated Rates clause in the service contract between installation and contractor makes sense, for many of the reasons cited by the regulated utility industry. However, use of the clause appears to be inconsistent with DoD policy, as stated in the DoD/GC memorandum.<sup>108</sup> That memorandum permitted limited state regulation of the utility privatization contractor, generally in the areas of utility system reliability and safety. Use of the Regulated Rates clause in privatization service contracts will permit state regulatory bodies to set the rates paid by federal installations to regulated utility privatization contractors.

The utility rates paid by military installations to their privatization contractors will be for the *on-base* operation and maintenance of the utility system involved. It is true that federal procurement policy presently requires, as a matter of comity, federal agencies to pay state commission-set utility rates. But that is for off-base service. State commissions have never regulated on-base utility systems. Therefore, use of the Regulated Rates clause in utility privatization service contracts should not be taken for granted. It is breaking new ground. But, if the federal government is willing to accept state commission jurisdiction in its relationship with its off-base utility providers, it should be no less willing to accept state commission jurisdiction over its relationship with its on-base regulated utility privatization contractor. The presence of the Regulated Rates clause in DoD utility privatization solicitations indicates that DoD is willing to accept state commission jurisdiction over its on-base regulated utility privatization contractor. But DoD policy as currently stated does not permit it.

The DoD should resolve the present policy disconnect by expressly revising the policy to allow use of the Regulated Rates clause in utility

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<sup>107</sup> H.R. 4205, 106<sup>th</sup> Cong. (2000).

<sup>108</sup> Memorandum, The General Counsel of the Dep’t of Defense, *supra* note 55.

privatization service contracts. One may logically assume that the DoD/GC memorandum only says that states do not possess jurisdiction over utility privatization contractors as *a matter of right*, but it is permissible to *contractually accede* to state jurisdiction. But the memorandum does not expressly state this.

#### 4. What Should DoD Policy Be?

It makes sense to use the Regulated Rates clause in the Military Services' utility privatization RFP template; however, several concerns about the use of the Regulated Rates clause can and should be addressed by modification of the RFP.

##### a. State Regulatory Jurisdiction Must be Assured

If an unregulated entity is selected as an installation's utility privatization contractor, a state regulatory commission will not regulate it. The Army and Air Force RFPs state that in the event an unregulated entity is selected, the Negotiated Rates clause will be inserted into the utility service contract.<sup>109</sup> If an installation selects a regulated utility as its privatization contractor, then presumably the installation intends to rely upon state regulatory oversight of the contractor, including the setting of the tariff rate to be paid. That regulatory oversight should not be assumed, but should be confirmed in the solicitation process.

In the *BG&E* case, BG&E obtained a formal opinion from the Maryland Public Service Commission's (PSC) General Counsel, stating that "it would have authority over any non-federal entity awarded the Army contract to own, operate and maintain the electric system at Fort Meade."<sup>110</sup> In that case, the Army successfully argued that the PSC would not have jurisdiction. However, if the Army is going to include FAR 52.241-7 in a utility service contract with a state-regulated utility company, it behooves the Army to ensure that the state commission will exercise jurisdiction. It seems that one of the major benefits of selecting a regulated utility company as the privatization contractor would be to obtain the oversight of the state regulatory commission. In the *BG&E* case, the Maryland commission affirmatively stated it would exercise jurisdiction. However, in other cases, state regulatory agencies have stated they would not exercise jurisdiction over a utility privatization

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<sup>109</sup> AIR FORCE RFP TEMPLATE, ARMY RFP TEMPLATE, *supra* note 18, at Section I.5. The Negotiated Rates clause, FAR 52.241-8, provides for negotiated utility rates between installations and unregulated utility providers, as opposed to a state commission-set tariff rate for regulated utilities.

<sup>110</sup> *Baltimore Gas & Elec. Co.*, 133 F. Supp. 2d at 732.

contractor. For example, the Colorado Public Utilities Commission (PUC) decided that it would not have any jurisdiction over the utility privatization contractor selected by Fort Carson, Colorado:

Relevant congressional action and executive agency regulation confirm that Commission regulation of the solicitation winner is precluded with respect to activities on the federal enclave portion of Fort Carson. This Commission does not have jurisdiction to mandate the identity of or to regulate the solicitation winner vis-à-vis the utility distribution facilities located within the federal enclave portion of Fort Carson.<sup>111</sup>

The Colorado PUC also stated that it would have no jurisdiction over the proprietorial interest portions of Fort Carson either, unless the “Federal contracting officer” decided to accept PUC authority.<sup>112</sup> It is true that the petition heard by the Colorado PUC was filed by Enron, an unregulated entity. However, the language used by the PUC in its decision is broad enough to include regulated utility companies as well. That is, it is fair to conclude that the PUC decision stands for the proposition that if a state PUC-regulated utility company was selected as the Fort Carson utility privatization contractor, the PUC would not exercise jurisdiction over it. The one caveat to that statement is that the Colorado PUC apparently would be able to exercise jurisdiction over the proprietorial areas of military installations, if agreed to by the government.

When a state-regulated utility company submits a proposal on a utility privatization solicitation containing the Regulated Rates clause, it should be required to submit a written statement from that state’s PUC, affirmatively stating that the PUC will exercise jurisdiction over the regulated utility company. If the regulated utility company cannot obtain such a statement from the state PUC, then the RFP should clearly state that the Regulated Rates clause will not be in effect, and rates will be negotiated between the installation and the utility company. The source selection authority should not give any weight to the benefits of state regulatory oversight if the regulated utility offeror cannot prove that the state regulatory body will exercise jurisdiction.

Will other state public utility commissions accept jurisdiction over the relationship between a federal military installation and its utility privatization contractor? State commissions would be treading where they have never tread before – regulating the operation of utility systems located on a federal installation. Some state commissions may decide, as the Colorado commission did, that they do not possess jurisdiction over federal enclave portions of installations. Other commissions may decide that they *could* exercise jurisdiction, but may nevertheless *decline* to exercise jurisdiction. They could very well point to the fact that the federal government in the DoD/GC

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<sup>111</sup> Enron Fed. Solutions, Inc., Docket No. 99D-242EG, Decision No. C00-807, Public Utilities Comm’n of the State of Colorado (July 19, 2000) (on file with author), at 12.

<sup>112</sup> *Id.* at 19, 20.

opinion<sup>113</sup> took the position that state law had no effect on the utility privatization contractor selection/solicitation process. Now, they might ask with irony, “The federal government is inviting our jurisdiction over its contractual relationship with the privatization contractor process?” The state PUCs could in essence feel they were earlier snubbed by the federal government and they will not now be so quick to assist it. For this reason, it is recommended that the installation ascertain early on whether the state public utility commission will in fact exercise jurisdiction over a regulated utility acting as the installation’s utility privatization contractor. The burden should be put on regulated utility offerors to *prove* that their state regulatory commission would exercise jurisdiction over them.

*b. State Regulatory Body Cannot be Given Jurisdiction Over Installation Security-Related Issues*

The Air Force has raised a legitimate concern regarding installation security that is not presently addressed in DoD utility privatization RFP templates that needs to be resolved.<sup>114</sup> The problem is that if state public utility commissions are given jurisdiction over on-base utility privatization contractors, they could compel an installation to allow on-base access of utility company employees that the installation might otherwise deem security threats.<sup>115</sup>

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<sup>113</sup> Memorandum, The General Counsel of the Dep’t of Defense, *supra* note 55.

<sup>114</sup> Position Paper, AF/ILEIO point paper, subject: Mather Natural Gas Privatization as a Case Study in Support of Legislative Proposals (19 July 2000) <[www.il/hq.af.mil/ile/ilei.htm](http://www.il/hq.af.mil/ile/ilei.htm). (AF/ILEIO, the Air Force Civil Engineer’s utility privatization division, has been “stood down,” and utilities privatization is now under AF/ILEX, The Civil Engineer’s Readiness and Installation Support Division, per the AF/ILE website.)

<sup>115</sup> *Id.* The AF/ILEIO point paper was written to dissuade Congress from passing the proposed 2000 Amendment to 10 USC § 2688. Had that amendment passed, state regulation of the utility privatization contractor would have been expressly recognized. The same sentiments however are still applicable in the context of a state regulatory body exercising jurisdiction over a regulated utility privatization contractor pursuant to the Regulated Rates clause. The point paper states in part,

Because the Air Force would have to comply with any ‘State laws, regulations, rulings and policies,’ a legislature, the state public utilities commission, or its staff would have authority to define access requirements to our property. For instance, the PUC or its staff could determine, as a matter of ‘policy,’ that a certain form of easement would be used, even though that easement would surrender the authority of the installation commander to exercise control over access. Some states have much more expansive civil rights laws than the federal government. To the extent we would have to comply with them regarding access by utility company employees, we would be compelled to allow access by persons who could pose a security threat, simply because the state laws do not recognize our concerns in that area.

Of course, had the House amendment to Section 2688 passed, state regulation of the utility privatization contractor would have been mandated. The amendment did not pass, but current DoD utility privatization RFPs would grant state commission jurisdiction over regulated utility privatization contractors pursuant to the Regulated Rates clause. Because DoD is granting state jurisdiction as a matter of comity – as a contractual right – DoD can surely tailor the contract to meet its needs and concerns. The utility privatization RFP should be revised to expressly state that while the contract includes the Regulated Rates clause, and therefore the installation will accept, as a matter of comity, rates set by the state commission, as well as certain terms and conditions of service, the installation commander remains the final authority on matters that he/she decides affect installation security. This would effectively deny the state commission the authority to determine which utility company employees could enter the installation. This must be clearly spelled-out in the RFP.

Some protections are already in place in the interest of installation security. The Air Force right of way template makes clear that access to installations is subject to the control of the installation's commanding officer. To solidify this, the same language should be included in the DoD utility privatization RFPs.<sup>116</sup>

Additionally, the Regulated Rates clause does state, "The Government shall not be bound to accept any new regulation inconsistent with Federal laws or regulations."<sup>117</sup> However, a state public utility commission could already have a regulation in place, concerning utility company employees' access to places of work, that might conflict with federal law. The state commission could take the position that the regulation was not "new" and therefore was

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<sup>116</sup> SECRETARY OF THE AIR FORCE, OFFICE OF GENERAL COUNSEL (SAF/GCN), RIGHT OF WAY FOR UTILITY SYSTEMS, DRAFT VERSION 5, SECTION 4.1 (Dec. 2000) (on file with author) [hereinafter "RIGHT OF WAY"].

In accepting the privileges and obligations established hereunder, Grantee recognizes that the Installation serves the national defense and that Grantor will not permit the operation, construction, installation, repair and maintenance of a utility system and the provision of utility services to interfere with the Installation's military mission. This Installation is a closed military installation and is subject to the provisions of the Internal Security Act of 1950, 50 U.S.C. §797. Access to the Installation is subject to the control of its commanding officer and is governed by such regulations and orders as have been lawfully promulgated or approved by the Secretary of Defense or by any designated military commander. Any access granted to Grantee, its employees, and its agents is subject to such regulations and orders.

*Id.*

<sup>117</sup> FAR 52.241-7(c).



applicable to a military installation. To avoid this possibility, the DoD utility privatization RFPs should clearly state that operation of the Regulated Rates clause is expressly subject to the right of way's reservation of security issues to the installation commander.

#### **E. In sum – What Exactly is the *Status Quo*, and What We Should Do About It?**

In its amendment to 10 U.S.C. § 2688 in 2000, Congress made clear it favors a competitive utility privatization contractor selection process. In its report discussing the amendment, the Senate Armed Services Committee also stated that DoD would be wise to allow state regulatory oversight of its relationship with a regulated utility privatization contractor. It makes sense to include the Regulated Rates clause in contracts with regulated utilities that are selected as utilities privatization contractors. The DoD should clarify its policy to so state. However, it should be pointed out to the contractors that both the right of way document, and the Regulated Rates clause itself, declare federal law supreme in the area of installation security. Further, in light of the fact that regulated utilities and state commissions have been told that state law and regulations can play no part in the contractor selection process, is it likely the state commissions will come back into the fold and agree to exercise jurisdiction over a regulated entity selected to be a utility privatization contractor? In Colorado, the answer appears to be “no.” Before an installation selects a regulated utility company as its privatization contractor, presumably relying upon the benefits of state regulatory oversight, that installation should assure itself that the state commission will indeed exercise that jurisdiction.

#### **V. THE MILITARY SERVICES' POLICY DOES NOT FAVOR THE USE OF REVERSIONARY CLAUSES IN UTILITY PRIVATIZATION CONTRACTS – SO, WHAT HAPPENS IF THE UTILITY PRIVATIZATION CONTRACTOR DEFAULTS?**

Current DoD policy disfavors use of reversionary clauses in utility privatization contracts. Black's Law Dictionary defines “reversion” as “a future interest in land arising by operation of law whenever an estate owner grants to another a particular estate, such as a life estate or a term of years, but does not dispose of the entire interest.”<sup>118</sup> 10 U.S.C. § 2688(a) states that a utility system conveyance “may consist of all right, title, and interest of the United States in the utility system or such lesser estate as the Secretary considers appropriate to serve the interests of the United States.”<sup>119</sup> The statute does not prohibit a “reversionary clause” in which the government

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<sup>118</sup> BLACK'S LAW DICTIONARY 1320 (7<sup>th</sup> ed. 1999).

<sup>119</sup> 10 U.S.C. § 2688(a) (1997).

reserves the right to buy back the system from the contractor in the event of a termination for default of the service contract.

There is no clear procedure for how military installations will regain ownership of their privatized utility systems should that ever become necessary. The regulated utility industry's lobbying efforts on behalf of the proposed House amendment to Section 2688 failed, but a point raised by them remains troubling: what if the utility privatization contractor defaults in contract performance, and the government must regain ownership of the on-base utility system?

### **A. The Potential Problems**

When an installation successfully privatizes a utility system, it will transfer ownership of that system to a private entity, the "utility privatization contractor." It will most likely enter into a fifty-year utility service contract with the utility privatization contractor to operate and maintain that system and provide utility service to the base, excluding the commodity. There are two potential troubling scenarios: first, the contractor defaults during the fifty-year contract performance period, becoming incapable of contract performance; or second, at the end of the fifty-year service contract, the contractor attempts to gouge the base on its price because it can. The contractor owns the system, after all, and the base will have no other available option to provide service. Do the services' utility privatization RFPs, which will blossom into utility service contracts between installations and contractors, adequately address these concerns and protect the government? The short answer is no.

The specific concern addressed here is a situation where an installation feels compelled to terminate a utility privatization service contract for default because the contractor is not properly operating and maintaining its system, and the installation is not receiving the level of utility service that it requires. A termination for convenience is not a big concern because presumably in that scenario, the base would no longer likely require utility service, due, perhaps, to a base closure.

#### *1. Default During the Life of the Contract*

In April 2000 the American Public Power Association (APPA) identified to Congress its concerns of allowing unregulated entities to compete for, and win, utility privatization awards. The APPA argued that in awarding utility privatization contracts to unregulated entities, the government ran the risk of future contract defaults, with adverse budgetary consequences for the government. The APPA argued that unregulated entities were much more likely to default on utility privatization contracts than regulated entities, due to "thin capitalization margins, higher costs of capital, an absence of any

obligation to serve the public, and a lack of regulated cost of service recovery through tariffed service rates.”<sup>120</sup>

In a 1998 article in E-Source, Steve Allenby noted:

Termination risks arise when it is unclear what happens when either party terminates the privatization agreement. Third-party financiers will assume most, if not all, of the termination liability of the utility, but only if clear language (including the use of termination schedules) outlines what costs the military base will pay at termination. What the base pays at termination is a critical question, because it is highly probable the utility will have made investments that will not be fully amortized at termination.<sup>121</sup>

This article will not address in great depth the issue of termination payments, i.e., what the government might owe to the contractor in the event of termination, or conversely, what the contractor might owe to the government. Rather, the focus is on the more basic issue of *how* the government would go about regaining ownership of the utility system in the event the contractor defaults on contract performance. If the contractor is not performing its contractual requirements, what procedure does the government use to regain possession of the utility system? The bill of sale transfers ownership of the utility system from the government to the contractor. The utility service contract contains standard FAR clauses that deal with terminating the contract for convenience or default. What document potentially affects the

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There is risk to the Government that, for a variety of reasons, sometime during the 50 year life of the utility privatization contract, the utility provider will default, abandon the utility system, or initiate early termination of the contract.... Compared to regulated entities, unregulated entities providing utility services are likely to have thin capitalization margins, higher costs of capital, an absence of any obligation to serve the public, and a lack of regulated cost of service recovery through tariffed service rates. It can be reasonably expected that the defaults, bankruptcies, system abandonments and early contract terminations for unregulated providers of distribution services would be as high as the rate of defaults for ‘investment’ grade entities. Historical data for defaults of investment grade entities indicates that over 250 systems will revert to the DoD at least one time during the initial 50-year privatization period. In addition, there may be instances in which DoD must reacquire problematic utility systems multiple times during the initial privatization term. The costs associated with utility system default, abandonment, or non-performance were estimated by identifying the costs related to three main activities required by the Government when a utility provider no longer is willing or able to provide the services required under the contract. These three activities and appropriated fund requirements are: initial physical assessment and recovery; ongoing utility system operation and maintenance; legal recovery of the system through repurchase and re-privatization.

APPA MEMORANDUM, *supra* note 83.

<sup>121</sup> Allenby, *supra* note 15, at 15.

government's rights vis-à-vis the system itself, if the contractor defaults on contract performance? The right of way provides some limited rights, as will be discussed further in section V.C. below.

## 2. Contractor Bargaining Advantage at Contract Term's End

The first area of concern is how the government would go about re-gaining ownership of an on-base utility system owned by an entity that defaults on the service contract. The second area of concern is how the government would go about re-gaining ownership of an on-base utility system owned by an entity that will not negotiate in good faith with the Government at the conclusion of the fifty-year contract performance period.

The APPA described the bargaining leverage held by a such an entity, calling the installations "captive customers" at the conclusion of the fifty-year contract term. The contractor owns the on-base utility distribution system, but has no obligation to serve the installation. The APPA argued that no such problem would occur if a regulated entity were the privatization contractor because the regulated company would have an obligation to serve the installation independent of the contract.<sup>122</sup> Presumably, an unregulated entity will be motivated to negotiate in good faith for a new service contract at the end of the initial fifty-year contract term. If the contractor does not reach an agreement with the installation, the contractor's stream of income ends. Nevertheless, the contractor will no doubt hold bargaining leverage.

The focus here is how to deal with these two potential problems. What options, if any, would be available to the government to regain ownership of the utility system at the end of the fifty-year service contract if the contractor proposes unreasonable contract terms? What options, if any, would be available to the government to regain ownership of the utility system during the life of the fifty-year service contract, if the contractor defaults?

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Bargaining leverage, as used in this study, is defined as the power held by a company due to its control of a particular market. At the expiration of a DoD contract an unregulated entity will be in a position of having complete control over the market for utility distribution services at a DoD installation because an installation essentially becomes a captive customer. Once the contract has expired, the utility service provider will own the distribution equipment but will have no obligation to serve the installation. Given that an installation will opt to renegotiate the service contract after 50 years, the unregulated entity will be able to charge a premium for service from then on. It is noted that a regulated utility will continue to provide service under its obligation to serve mandate. In the absence of a negotiated contract, the regulated utility will provide service at a tariff rate schedule.

APPA MEMORANDUM, *supra* note 83, at iv.

## B. Current Services' Practice

Section B.2.3, of the Air Force competitive RFP template reads in part, “[T]he United States will retain no reversionary interests in the utility system sold, other than the Right of Way upon its expiration or termination.”<sup>123</sup> The Army RFP template, developed by the Defense Energy Service Center (DESC), does not contain specific language regarding reversionary clauses or the lack thereof, but the utility privatization RFP released by Fort Lewis in 1999 contained similar language to that found in the Air Force RFP template; no reversionary interest will be retained by the Army.<sup>124</sup>

This is a very hazy area in utility privatization implementation and one that concerns installation commanders, who are interested in the reliability and continuity of their installation's utility service. To date, the question of what happens if the privatization contractor defaults remains unanswered.<sup>125</sup> The official Air Force utility privatization website<sup>126</sup> contains the following responses to frequently asked RFP questions: (1) “Question: What becomes of the utility system after termination of the service contract? Answer: That question is not resolved by the contract.”<sup>127</sup> (2) “Question: How will the Government obtain utility service after termination of the service contract, if only one potential source owns the system? By sole source award? Answer: This question is beyond the scope of the RFP.”<sup>128</sup>

A potential bidder on the Maxwell/Gunter AFB utility privatization solicitation noted that the government retained no reversionary interest in the privatized utility systems. This bidder asked what would be the consequences if, after a system was sold, a state regulatory authority determined that the system owner cannot own the system and/or provide service in accordance

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<sup>123</sup> AIR FORCE RFP TEMPLATE, *supra* note 18, at Section B.2.3.

<sup>124</sup> DIRECTORATE OF CONTRACTING, FORT LEWIS, WASHINGTON, AMENDMENT OF SOLICITATION/MODIFICATION OF CONTRACT (22 Aug. 2001) <<http://www.lewis.army.mil/doc/solicitations/00r2/amend3/Amendment%2000003%20%2022%20Aug%2001.doc>>.

<sup>125</sup> For example, the following comments are found in an Army Judge Advocate General School outline on “Competitive Sourcing and Privatization,” – “Reversionary clauses. The contractual agreement must protect the government's interests in the event of a default termination. The use of reversionary clauses, which revoke the conveyance of the utility system, are but one option. Presently, the Army General Counsel's office does not favor the use of reversionary clauses as the means to accomplish this end.” U.S. ARMY JUDGE ADVOCATE GENERAL'S SCHOOL, CONTRACT & FISCAL LAW DEP'T, COMPETITIVE SOURCING AND PRIVATIZATION OUTLINE (Jan. 2001) (on file with author). The outline does not discuss what “other options” are available, because none have been formally identified.

<sup>126</sup> <http://www.afcesa.af.mil/Directorate/CEO/Contracts/UtilPrivatization/default.htm> (AIR FORCE CIVIL ENGINEER SUPPORT AGENCY (AFCESA/CEOC), AIR FORCE UTILITIES PRIVATIZATION FREQUENTLY ASKED RFP QUESTIONS (26 Sep. 2000) (also on file with author)).

<sup>127</sup> *Id.*

<sup>128</sup> *Id.*

with the contract terms?<sup>129</sup> Although not specifically asked by the bidder, a related question is what would the consequences be if the utility privatization contractor became unable to provide service in accordance with the contract terms? The Air Force response referred to DESC responses given to potential bidders on the Texas Regional Demonstration solicitation. The DESC response was that the RFP and resulting contracts are governed by federal law; therefore the government would “not speculate on the potential consequences if other parties take a different position.”<sup>130</sup>

The DESC response only answers the question posed by the potential bidder, as it should have. The response implied that the government believed that a state regulatory commission would be unable to affect a utility privatization contractor’s ability to perform a contract. However, what would the consequences be if the utility privatization contractor defaults on the contract for some other reason, for example, taking a financial turn for the worse? A related issue is what would be the effect if the installation and the utility privatization contractor are unable to successfully negotiate a follow-on service contract at the end of the initial fifty-year term?

The January 2002 Navy utilities privatization Quarterly Report stated that it was “imperative” to add reversionary rights to utility privatization contracts.<sup>131</sup> A utility privatization working group comprised of representatives of all the services and of several disciplines is presently reviewing the use of reversionary clauses. It is possible that future guidance “might direct that such clauses are optional and at the discretion of the Services.”<sup>132</sup>

### C. The Right Of Way

The third piece of the utility privatization trinity is the right of way. The bill of sale transfers ownership of the utility system. The utility service contract obligates the contractor to operate and maintain the system and to provide reliable utility service to the base. The right of way is the document that allows the contractor access on the base to maintain its utility system. It contains some provisions that impact upon the two termination scenarios discussed herein.

The right of way used by the Air Force is for a term of seventy-five years.<sup>133</sup> The government has the sole discretion to renew the right of way at the end of the seventy-five year term.<sup>134</sup> Paragraph twelve of the right of way

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<sup>129</sup> *Id.*

<sup>130</sup> DEFENSE ENERGY SUPPORT CENTER, TEXAS REGIONAL DEMONSTRATION SOLICITATION, ANSWER TO QUESTION 80, *supra* note 104.

<sup>131</sup> DEP’T OF THE NAVY QUARTERLY REPORT, *supra* note 27.

<sup>132</sup> UTILITIES PRIVATIZATION WORKING GROUP, DEP’T OF DEFENSE, MEETING MINUTES (Feb. 28, 2002) (on file with author) [hereinafter “Utilities Privatization Working Group”].

<sup>133</sup> RIGHT OF WAY, *supra* note 116, at 4.

<sup>134</sup> *Id.* at 4.

states that the government may terminate it for the contractor's failure to comply with its provisions, after giving the contractor a ten day cure period and an additional seven days to respond to a written notice of termination.<sup>135</sup> Paragraph twenty-seven of the right of way gives the government the right to terminate it if the contractor abandons its utility system.<sup>136</sup>

Obviously, the right of way is important to the utility service contractor because, without it, the contractor cannot enter the base to operate and maintain its utility system. If the contractor abandons the system for a year, then the government can terminate the right of way, effectively terminating the contractor's status as the installation's utility privatization contractor. The contractor nevertheless owns the system. Further, what happens during that one year period when the contractor is not providing service because he has abandoned the system? The Army and Air Force RFP templates do contain clauses giving the government the right "to perform or supplement performance of contract functions with government personnel during periods of disaster, war emergencies, police actions, or acts of God affecting the installation."<sup>137</sup> Arguably, a contractor's abandonment of its utility system and its failure to provide needed service may well result in a disaster on the installation that the installation could remedy by performing the work necessary to keep the particular utility running. However, the issue remains of how the government would regain ownership of a system that has been abandoned or is not being properly operated and maintained by the contractor, resulting in termination by default of the utility service contract, and/or termination of the right of way.

#### **D. Options Available to the Government to Regain Utility System Ownership, if Necessary**

##### *1. Eminent Domain Proceeding*

The Fifth Amendment to the United States Constitution does not forbid governmental taking of private property; it mandates, however, that the property owner be justly compensated.<sup>138</sup> In the event a utility privatization contractor failed to perform its contractual duty to operate and maintain its utility system, thereby failing to deliver the needed utility service to the installation, the installation would be able to assume ownership of the system

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<sup>135</sup> *Id.* at 9 - 10.

<sup>136</sup> *Id.* at 17 ("Abandonment shall consist of Grantee failing to utilize the Premises, or any part of them, to provide services to customers for a period of one year.").

<sup>137</sup> AIR FORCE RFP TEMPLATE, *supra* note 18, at SECTION H.6, "Rights of the Government to Perform Function with Its Own Personnel."

<sup>138</sup> U.S. CONST., AMEND V.

via eminent domain. Of course, the contractor would have to be compensated for his property.<sup>139</sup>

Courts have often upheld the government's eminent domain rights. In *United States v. Brooklyn Union Gas Co.*, for example, the United States, wanting to expand the Brooklyn Navy Yard in 1941, took the facilities of two public utility companies, one supplying gas, the other electricity.<sup>140</sup> In *United States v. Jones*,<sup>141</sup> the United States took back lands and works of improvement – locks, dams, canals, and other structures – that it had previously ceded to the State of Wisconsin, and were now owned by a private entity named “the Green Bay and Mississippi Canal Company.” In those cases, it was undisputed the United States had the inherent authority to take the private property of the companies. The issue in those cases was the amount of just compensation to be paid to the companies. Courts use complex methods to determine “just compensation” for government-taken property.<sup>142</sup>

If the government does not provide for some “hard and fast” termination procedures in the utility service contract, the government's

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The power to take private property for public uses, generally termed the right of eminent domain, belongs to every independent government. It is an incident of sovereignty, and, as said in *Boom v. Patterson*, 98 U.S. 106, requires no constitutional recognition. The provision found in the Fifth Amendment to the federal Constitution, and in the Constitutions of the several States, for just compensation for the property taken, is merely a limitation upon the use of the power. It is no part of the power itself, but a condition upon which the power may be exercised.

*United States v. Jones*, 109 U.S. 513 (1883).

<sup>140</sup> *United States v. Brooklyn Union Gas Co.*, 168 F.2d 391 (2d Cir. 1948).

<sup>141</sup> *United States v. Jones*, 109 U.S. 513 (1883).

<sup>142</sup> See e.g., *Onondaga County Water Auth. v. New York Water Service Corp.*, 139 N.Y.S. 755 (N.Y. App. Div. 1955).

The valuation of utility properties in eminent domain proceedings presents unique problems. The absence of sales of similar property is one difficulty. For another thing, the taking includes not just the property, but also the business, and the two are practically inseparable. The standard of compensation in utility condemnations is an extremely vague one, and although many tests are considered, none seems to be controlling. No rigid measures can be prescribed for the determination of ‘just compensation’ under all circumstances and in all cases. No hard and fast rule can be laid down that will cover every case or fix in advance the limit of the matters which may be taken into consideration by the commissioners in any particular case. Various tests have been applied, alone and in combination. The usual method of fixing the value of property for taking is by ascertaining market value. But there is hardly a market, in the usual sense, for a public utility, particularly a regulated utility. Resort must therefore be made to other tests of value, and what is used is largely a matter of judgment and circumstance.

*Id.* See also L.S. Tellier, Annotation, *Compensation or Damages for Condemning a Public Utility Plant*, 68 A.L.R.2d 392 (2001).



termination liability will be determined by vague “just compensation” standards, in the event it is forced to re-take ownership of a utility system.<sup>143</sup> Instead, the government should know what its termination liability, if any, would be were it to regain ownership of a utility system. The only way to do that is include termination liability in the utility service contract.

## 2. *Reversionary Clause in the Utility Service Contract*

The military services’ present policy is to not include reversionary clauses in utility privatization service contracts, despite the fact that 10 U.S.C. § 2688 would permit it. The present Army and Air Force RFP templates do contain the standard FAR clauses on Termination for Convenience<sup>144</sup> and Termination for Default.<sup>145</sup> However, these clauses are not well-suited to deal with a privatized situation. In the typical termination scenario envisioned by these clauses, the government is terminating a service-providing contractor. In a privatization scenario, however, the government is terminating not only a service provider, but also the owner of the service-delivery system. In essence, the government is terminating the services of *the only entity legally authorized to perform the services* – the utility service contractor. So, while the government is authorized by both the service contract and the right of way to terminate the services of the utility services contractor, how does the government go about “terminating” the contractor’s status as utility system owner? Before the government can either operate the utility system, or contract out its operation to another entity, it must regain ownership of the utility system. Certainly, the government may be able to step in and run the system on a temporary basis, but would not be able to operate and maintain the terminated utility privatization contractor’s system on the longer term without re-acquiring ownership of the system. Nothing contained in either the present Army or Air Force RFP template, or Air Force right of way, gives the government the right to re-take a utility system, and nothing gives the installation the right to operate and maintain the utility privatization contractor’s system, other than Section H.6 which would allow government personnel to perform contract functions in the event of a disaster or act of God.<sup>146</sup>

Steven Allenby’s article discusses the question of what happens to the installation distribution system if the utility does not renew the service contract at the end of its term.<sup>147</sup> A related question is what happens to the installation distribution system if for some reason the utility service contract is terminated

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<sup>143</sup> *Onondaga*, 139 N.Y.S. 755 (1955).

<sup>144</sup> FAR 52.249-2

<sup>145</sup> FAR 52.249-8

<sup>146</sup> AIR FORCE RFP TEMPLATE; ARMY RFP TEMPLATE, *supra* note 18, at Section H.6.

<sup>147</sup> Allenby, *supra* note 15, at 15.

before the end of its term? In that situation, an entity owns the system but is not contractually authorized to operate and maintain it.

Mr. Allenby describes a model Army utility privatization service contract he reviewed which stated “the utility must give three years’ notice if it does not intend to renew the contract. It also says the installation will pay the present value of any unamortized capital investments when the contract ends, and it says the installation has the right to buy back its distribution system for \$0.”<sup>148</sup> Neither the present Army or Air Force RFP template contain such a provision. However, such a provision would cover a situation where the contractor is not willing to renew the service contract. It could also be drafted to cover a situation where the government was unable to secure what it believed to be favorable terms/price for the new service contract, and also a situation where the government felt compelled to terminate the service contract for default.

This “buy back provision” is the type of reversionary clause needed in the utility privatization service contract. The provision should state that in the event the contractor defaults on its contractual service obligations, or in the event that the contractor and the government are unable to reach agreement on a new service contract at the end of the fifty-year service contract term, the government will be allowed to buy back the system at no cost. This may seem patently unfair to the contractor/system owner at first glance, but consider that if the government is forced to terminate the contractor for default, then the contractor would not have been doing the job it agreed to perform. Therefore, the contractor should not be paid anything, other than the cost of any system infrastructure improvements that may have been made, for which it has not been fully compensated. Further, it is assumed that by the end of the fifty-year service contract, the contractor will have been fully compensated for all system improvements, but if that is not the case, the contractor should receive compensation for any unamortized improvements.

A standard FAR contract clause, 52.241-10, Termination Liability, exists that could be tailored for use in a utility privatization service contract.<sup>149</sup> This clause is typically used in situations where a utility company has constructed facilities on base, and also provides utility service to the base. The utility is not paid a lump sum for the construction, but rather the cost is billed out over several years. It is basically incorporated into the company’s monthly utility bill to the base. The clause is activated in situations where the service contract is terminated for whatever reason, typically due to base closure, but in any event, prior to the company receiving full compensation for the construction. This clause could also be adapted for use in utility privatization service contracts, and provide an agreed-upon means of compensation to a utility privatization contractor whose service contract is terminated. Even

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<sup>148</sup> *Id.* at 15.

<sup>149</sup> FAR 52.241-10.

though terminated for default, the contractor may still be due compensation for any facilities he has built and has not fully been paid for. Use of this clause, along with a reversionary clause, is preferable to regaining ownership of a utility system via eminent domain and the uncertainty of how a court will arrive at just compensation for the contractor.

## **VI. MUNICIPAL UTILITY COMPANIES: NEGOTIATED RATES CLAUSE VERSUS REGULATED RATES CLAUSE**

The Regulated Rates clause is for use in contracts with regulated utilities. The Negotiated Rates clause is for use in contracts with unregulated utilities.<sup>150</sup> Municipal utility companies generally want to be treated as regulated utilities, but federal procurement policy considers them unregulated. This divergence of opinion has already scuttled utility privatization negotiations between a military installation and a municipal utility company and likely renders future such negotiations at other installations troublesome.

### **A. The Issue**

Municipal utility companies are one of the entities mentioned in 10 U.S.C. § 2688 as potential utility privatization contractors. Municipal utility companies are owned and operated by municipalities and usually are not regulated by their statewide public utility commission.<sup>151</sup> Municipal utilities sometimes take the position that they are “regulated,” and therefore should be able to unilaterally set utility rates for military installations should they be selected as the utility privatization contractor.<sup>152</sup> The government position is that defense acquisition regulations require the use of a negotiated rates procedure when dealing with municipal utility companies.<sup>153</sup> This difference

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<sup>150</sup> See discussion *supra* sections I, II D, and IV D. 2 regarding regulated and unregulated utility companies vis-a-vis the Regulated Rates clause and the Negotiated Rates clause.

<sup>151</sup> See generally AIR FORCE LOGISTICS MANAGEMENT AGENCY, UTILITY CONTRACTING REFERENCE GUIDE (Sept. 1996) (on file with author), at 6 [hereinafter “AIR FORCE LOGISTICS MANAGEMENT AGENCY GUIDE”] (“Municipals are unique in operation, financing, and the way they are regulated. The vast majority of municipal utilities are self-regulated. State Public Service Commissions have little or no regulatory authority for operations, services, and rates imposed by the Municipals. Many Municipals pattern accounting and service standards along state and federal regulatory standards, but for the most part they are independent of state regulatory oversight.”).

<sup>152</sup> As a Trial and Negotiation Attorney assigned to the Air Force Utility Litigation Team, Air Force Legal Services Agency, Tyndall AFB, Florida, from 1999-2001, the author was personally involved in negotiations with several municipal utility companies that took the position they were “regulated” and therefore their contracts with the Federal Government should include the Regulated Rates clause.

<sup>153</sup> DFARS 241.201; FAR 41.402. The latter reads, “If the utility supplier is not regulated and the rates, terms, and conditions of service are subject to negotiation pursuant to the clause at

of opinion resulted in the breakdown of utility privatization negotiations between an Air Force Base and a municipal utility company, for the base's electric distribution system.<sup>154</sup> The municipal utility argued that FAR 52.241-7, "Change in Rates or Terms and Conditions of Service for Regulated Services,"<sup>155</sup> should be used in the utility service contract, while the Air Force wanted to use the clause found at FAR 52-241-8, "Change in Rates or Terms and Conditions of Service for Unregulated Services."<sup>156</sup> In essence, municipal utility companies want to be treated the same way as those utility companies regulated by state public utility commissions. For example, the municipals want DoD to unilaterally accept rates established by their City Council, as is permitted by the Regulated Rates clause. The same issue will likely jeopardize future utility privatization negotiations between installations and municipal utility companies.

### **B. Why the Difference in Opinion Between DoD and Municipal Utility Companies? What Are The Applicable Regulations?**

The DFARS defines a "regulated utility supplier" as a "utility supplier regulated by an independent regulatory body."<sup>157</sup> It defines "independent regulatory body" as "the Federal Energy Regulatory Commission, a state-wide agency, or an agency with less than statewide jurisdiction when operating pursuant to state authority."<sup>158</sup> It defines a "nonindependent regulatory body" as "a body that regulates a utility supplier which is owned or operated by the same entity that created the regulatory body, e.g., a municipal utility."<sup>159</sup> The DFARS 241.201, "Policy," states:

Except as provided in FAR 41.201, DoD, as a matter of comity, will comply with the current regulations, practices and decisions of independent regulatory bodies which are subject to judicial appeal. This policy does not extend to regulatory bodies whose decisions are not subject to appeal nor does it extend to nonindependent regulatory bodies.<sup>160</sup>

Municipal utilities are by definition, at least in defense acquisition regulatory parlance, not "regulated." Typically, the municipal utility's rates

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52.241-8, Change in Rates or Terms and Conditions of Service for Unregulated Services, any rate change shall be made a part of the contract by contract modification."

<sup>154</sup> The author participated in these negotiations as an advisor to the particular Air Force installation and Major Command involved. The parties' identities will not be revealed so as not to jeopardize and compromise potential future negotiations between the parties.

<sup>155</sup> FAR 52.241-7.

<sup>156</sup> FAR 52.241-8.

<sup>157</sup> DFARS 241.101.

<sup>158</sup> *Id.*

<sup>159</sup> *Id.*

<sup>160</sup> DFARS 241.201.

and terms and conditions of service are established by that municipality's legislative body, not by an independent statewide commission.

The argument in favor of allowing municipal utility companies to use the Regulated Rates clause points to FAR 41.501, which directs contracting officers to insert the Regulated Rates clause in contracts "when the utility services are subject to a regulatory body."<sup>161</sup> This contract clause itself states that it is applicable to the extent that services furnished under the contract are "subject to regulation by a regulatory body."<sup>162</sup> The argument is that the FAR requires use of the Regulated Rates clause when the services are furnished subject to regulation by a regulatory body, with no further definition of "regulatory body" like that found in DFARS Part 241. The municipal utility companies say that they are indeed regulated, and that even if regulated by their own city council, this fits within the FAR definition providing that the Regulated Rates clause should be used.

The DFARS should be read in conjunction with the FAR. The FAR does not specifically define "regulatory body," but the DFARS does. The DFARS definition generally excludes municipal utilities from the definition of "regulated utility."<sup>163</sup> The DFARS language is not inconsistent with the FAR provisions; it merely supplements the FAR. The DFARS policy does not explain the rationale for the differentiation between municipal utilities and state-regulated utilities, but it seems rather obvious. The federal government does not want its utility providers to have authority to set their own rates, without any "independent" review. In the case of municipals, the utility provider and the rate-setting body are one and the same – the municipality.<sup>164</sup> In the case of state-regulated utilities, the "independent" state commission reviews, and approves, proposed rates. The next section will discuss a case that specifically upheld the use of a Negotiated Rates clause in a utility service contract between the City of Tacoma, Washington, and McChord AFB, Washington.

### C. Caselaw

The dispute in the *City of Tacoma v. United States* involved a 1972 contract between the City and McChord AFB, Washington, in which the City agreed to provide electrical services to the base.<sup>165</sup> The City of Tacoma was acting in its capacity as a municipal utility company. The contract contained a negotiated change of rates clause that the parties used to successfully negotiate nine rate changes between 1973 to 1977.<sup>166</sup> The City of Tacoma, however,

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<sup>161</sup> FAR 41.501.

<sup>162</sup> FAR 52.241-7.

<sup>163</sup> DFARS 241.101.

<sup>164</sup> AIR FORCE LOGISTICS MANAGEMENT AGENCY GUIDE, *supra* note 150.

<sup>165</sup> *City of Tacoma v. United States*, 31 F.3d 1130 (Fed. Cir. 1994).

<sup>166</sup> *Id.* at 1131.

later challenged the negotiated rates clause as being illusory, arguing that the clause was merely an “agreement to agree” permitting the government to refuse to accept new rates, without consequence.<sup>167</sup> The Court rejected this argument, finding that the government clearly had a contractual obligation to negotiate in good faith.<sup>168</sup>

The City of Tacoma did not advance the argument that some advocate now, that the FAR and DFARS are somehow in conflict because the FAR does not specifically exclude self-regulated municipal utility companies from the definition of “regulated utilities.” In fact, the Court found that the Negotiated Rates clause was totally appropriate between a government agency and a municipal utility company.

#### **D. Solution?**

The government apparently intends to use FAR 52.241-7, the Regulated Rates clause, in utility service contracts between itself and utility companies regulated by independent statewide commissions.<sup>169</sup> The DFARS provisions discussed above clearly state that municipal utility companies not regulated by statewide commissions are not to be accorded the status of “regulated utility.” Therefore, rates and terms and conditions of service between municipal utility companies and the government must be subject to FAR 52.241-8, the Negotiated Rates clause.<sup>170</sup> Current DoD procurement policy does not allow the use of the Regulated Rates clause<sup>171</sup> in contracts between installations and municipal utility companies, nor should it. Municipal utility companies desiring to compete for utility privatization awards will have to accept the use of the Negotiated Rates clause<sup>172</sup> in their contracts, or forego competing for privatization awards.

### **VII. CONCLUSION**

The military services appear to be doing the smart thing in taking the time to benefit from lessons learned in utility privatization implementation. The DoD should encourage the services to continue thinking and acting smart and should not stringently enforce artificial, unreasonable time standards for completion of privatization projects. The DoD should ensure that its policies are clearly stated and understood by all the services. If privatization of military utility systems is no longer mandatory, but is now an option, this

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<sup>167</sup> *Id.* at 1132.

<sup>168</sup> *Id.*

<sup>169</sup> See discussion *infra* section IV.D.3. regarding use of FAR 52.241-7 in DoD utility privatization solicitation templates.

<sup>170</sup> FAR 52.241-8.

<sup>171</sup> DFARS 241.201.

<sup>172</sup> FAR 52.241-8.

should be clearly stated. The DoD should also be generous in extending privatization timelines, if privatization implementers – those situated where “the rubber meets the road” – believe they need the extra time. Recent indications from DoD to the effect that the deadlines will be extended “a year or two” are encouraging.<sup>173</sup>

The DoD should further clarify its policy on the role of state law and regulation as it pertains to the relationship between installations and their utility privatization contractors. It should confirm that use of the Regulated Rates clause<sup>174</sup> is expressly permitted by DoD policy. Use of this clause will not grant state jurisdiction over utility privatization contractors by right, but rather by contract. In instances where regulated utility companies win utility privatization contracts, installations should take advantage of the regulatory oversight provided by state public utility commissions, after assuring themselves that the commission will in fact exercise jurisdiction. In no instance, however, can installations agree to state control over installation security issues, such as installation access.

While DoD is smart to use the Regulated Rates clause<sup>175</sup> in contracts between its installations and state commission-regulated utilities, it must insist on use of the Negotiated Rates clause<sup>176</sup> in contracts between installations and self-regulated municipal utilities.

The DoD also appears to be moving in the right direction on use of a reversionary clause in privatization contracts. Some type of reversionary clause is needed to clearly spell out how an installation will regain ownership over a utility system if that need arises as well as the parties’ financial obligations in the event of utility service contract termination.

Policy needs to be practical, realistic, and helpful to utility privatization implementers. There is no substitute for common sense in this process, and the services’ current measured approaches indicate that common sense and application of lessons learned will govern their stewardship of DoD’s Utility Privatization Program.

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<sup>173</sup> Cahlink, *supra* note 7.

<sup>174</sup> FAR 52.241-7.

<sup>175</sup> *Id.*

<sup>176</sup> FAR 52.241-8.

# TERMINATIONS FOR CONVENIENCE AND THE TERMINATION COSTS CLAUSE

MAJOR GRAEME S. HENDERSON\*

## I. INTRODUCTION

You are a first or second assignment Assistant Staff Judge Advocate assigned to a base or even an air logistics center. When you arrive at the base your boss, the Staff Judge Advocate (SJA), tells you that you will be the new contracts attorney and you will advise the contracting squadron on all contract matters. Somewhere in the back of your mind, you can recall snippets of contract law from law school, from your bar review a couple of years ago or maybe even from your two weeks at the Army JAG School Contract Attorney's Course.

One bright, sunny day, you get a voice mail message from a civilian in the contracting squadron who identifies himself as the termination contracting officer for the Moab Industries (MI) termination. In the message, he first congratulates you on your new assignment. He then mentions that his ACO has sent notification to MI terminating the contract, he has conducted the post termination conference, and DCAA has finished auditing MI's termination settlement proposal. The audit has questioned a number of termination settlement costs, and the TCO needs a legal opinion about whether to disallow the questioned costs in the termination settlement. He also wants you to go with him to the termination settlement conference to advise him.

Not being a career contracts attorney, you wonder what he is talking about: "This doesn't sound like Contracts 101," you say. What is a termination contracting officer (TCO)? How, exactly does a termination work? What is DCAA? What are termination costs? What does the TCO mean by "questioned" and "disallow"?

This primer will provide guidance and be a reference for exactly this type of situation. It will briefly outline the termination for convenience

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process under FAR Part 49, explain who the participants are and what they do, and describe the process they are trying to follow as they finalize a convenience termination. Finally, it will analyze FAR 31.205-42, Termination Costs, and provide guidance on handling the types of costs specific to a termination settlement.

## II. TERMINATION FOR CONVENIENCE

### A. Generally

Termination for Convenience is a unique right reserved by the Government in its contracts, giving the Government the right to terminate a contract without cause at any time after award.<sup>1</sup> What the contractor receives in compensation for such a termination are various “costs” arising from the termination.<sup>2</sup> In virtually every case, the termination for convenience clause<sup>3</sup> entitles the contractor to recover costs incurred, profit on work done, and costs of preparing the termination proposal<sup>4</sup> no matter what type of contract it executed with the Government.<sup>5</sup>

The mechanics of getting to a termination for convenience are fairly straightforward. The Government, in the form of the requiring activity, determines that it no longer needs the goods or services required by the contract and formulates a reason why it is “in the Government’s interest” to terminate the contract.<sup>6</sup> The requiring activity informs the Contracting Officer (CO) who has authority to terminate the contract.<sup>7</sup> At this point, the CO becomes a Termination Contracting Officer (“TCO”)<sup>8</sup> or, if the command has

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<sup>1</sup> JOHN CIBINIC, JR. & RALPH C. NASH, JR., ADMINISTRATION OF GOVERNMENT CONTRACTS, 1073 (3d ed. 1992).

<sup>2</sup> GENERAL SERVS. ADMIN. ET AL., FEDERAL ACQUISITION REGULATION 31.001 (June 1997) [hereinafter FAR]. There are many different types of costs, defined in FAR 31.001, Definitions. *Id.* The easiest way to describe contract costs is that they are the expenses that a contractor pays to manufacture goods or deliver services. This includes everything from the cost of the raw materials, such as steel bars, to the costs associated with secretarial services supporting the president of the company.

<sup>3</sup> FAR, *supra* note 2, at 52.249-1 through 52.249-7 contains seven different versions of the Termination for Convenience clause that can be included by reference in a Government contract. Each clause is tailored to a different type of contract from Fixed-Price type contract to Fixed-Price Architect-Engineer type. *Id.* at 52.249-1 through -7.

<sup>4</sup> CIBINIC & NASH, *supra* note 1, at 1073.

<sup>5</sup> The distinction being that for Firm Fixed Price contracts, a contractor would normally recover all of the costs incurred and profit in the unit price of the items purchased when they are completed. For cost reimbursement type contracts the contractor would already be entitled to costs incurred and profit on work done according to FAR Part 31.

<sup>6</sup> FAR, *supra* note 2, at 49.101(b).

<sup>7</sup> *Id.* at 49.101(a).

<sup>8</sup> *Id.* at 49.001. The FAR defines Termination Contracting Officer as “a contracting officer who is settling terminated contracts.” *Id.*

sufficient contracting staff,<sup>9</sup> the CO transfers responsibility to a permanently appointed TCO.<sup>10</sup>

FAR Part 49 governs the TCO's actions and incorporates the FAR 52.249, Termination of Contracts, clauses into the contract by reference.<sup>11</sup> The TCO must first notify the contractor in writing that the Government is terminating the contract.<sup>12</sup> The writing must include the effective date of the termination, the extent of the termination, any special instructions, and any special steps the contractor should take to minimize the impact on personnel if the termination will result in a significant reduction in the contractor's work force.<sup>13</sup> Once notified, the contractor must stop work immediately, terminate all subcontracts, and begin preparing its termination settlement proposal.<sup>14</sup>

The TCO's primary objective in a termination for convenience is to negotiate with the contractor to reach a bilateral agreement settling the termination.<sup>15</sup> The TCO's settlement authority is not unlimited, however. The TCO must follow the cost principles associated with reimbursement of cost type contracts found in FAR Part 31, Contract Cost Principles and Procedures.<sup>16</sup>

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<sup>9</sup> In the Air Force, some large bases and Air Logistics Centers (Wright-Patterson AFB, Hill AFB, Tinker AFB, Warner-Robins AFB) have permanently appointed TCOs. For instance, U.S. DEP'T OF THE AIR FORCE, AIR FORCE MATERIEL COMMAND FEDERAL ACQUISITION REG. SUPP. 5349.101 (2000)[hereinafter AFMCFARS] available at <http://farsite.hill.af.mil/vfafmca.htm> (last visited July 19, 2002), requires each Air Logistics Center (ALC) Senior Center Contracting Officer to appoint at least one TCO for the ALC. *Id.* When the author was assigned to Defense Contract Management Agency, Defense Contract Management Command, Van Nuys, California, the Van Nuys area staff included five full-time TCOs.

<sup>10</sup> There are no formal requirements for the transfer of terminated contracts from a CO to a TCO in the FAR. In the author's experience, each command formulates its own criteria for the transfer of terminated contracts to TCOs.

<sup>11</sup> FAR 52.249 termination clauses are mandatory clauses for the contract types to which they apply. FAR, *supra* note 2, at 52.301. See the solicitation provisions and contract clauses (Matrix) at FAR 52.301 for a quick reference for which clause is mandatory for each different type of contract. According to W. NOEL KEYES, GOVERNMENT CONTRACTS UNDER THE FEDERAL ACQUISITION REGULATION, 40-42 (2d Ed. 1997), the *Christian Doctrine*, (G.L. Christian and Assocs. v. United States, 160 Ct. Cl. 1, 60-61, 312 F.2d 418 (1963), *cert. denied*, 375 U.S. 954 (1963)) reads a termination clause into a government contract that is required by regulation by operation of law, even if the clause was not originally included in the contract. *Id.*

<sup>12</sup> FAR, *supra* note 2, at 49.102(a).

<sup>13</sup> *Id.* at 49.102(a)(1-5).

<sup>14</sup> *Id.* at 49.104(a-i).

<sup>15</sup> *Id.* at 49.201(b).

<sup>16</sup> *Id.* at 49.113.

## B. Termination Steps

Termination procedures after notice to the contractor are set out by each command and are based upon the FAR's requirements. A good example of such procedures are those of the Defense Contract Management Agency ("DCMA").<sup>17</sup> When a DCMA TCO receives the notice of a need to terminate a contract, the TCO first prepares and reviews the termination notification for completeness.<sup>18</sup> It is at this stage that the TCO might consider coming to the contracts attorney for assistance in reviewing the notice of termination.<sup>19</sup> After review, the TCO issues the termination notice and conducts the post termination conference.<sup>20</sup> At this conference, the TCO advises the contractor on the termination process<sup>21</sup> including the requirement for submission of the termination settlement proposal to the TCO.<sup>22</sup>

As alluded to above, a termination for convenience essentially treats a fixed-price contract as a cost-type contract,<sup>23</sup> so the TCO (and the contracts attorney) should be familiar with FAR Part 31 and cost-reimbursement contracting. To work towards settlement, the TCO will have to examine the termination settlement proposal to determine whether the costs asserted by the contractor are "allowable"<sup>24</sup> under the terminated contract. Allowability is a term of art (defined at FAR 31.201-2) composed of several factors: reasonableness,<sup>25</sup> allocability,<sup>26</sup> cost accounting standards,<sup>27</sup> the terms of the contract,<sup>28</sup> and the limitations of FAR subpart 31.201.<sup>29</sup>

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<sup>17</sup> U.S. DEP'T OF DEFENSE, DEFENSE CONTRACT MANAGEMENT AGENCY DIRECTIVE 1, Section 10.1 (Aug. 1999)[hereinafter ONEBOOK]; *available at* <http://www.dcma.mil/onebook/10.0/10.1/Termination.htm> (last visited July 19, 2002). The ONEBOOK is DCMA's regulatory guidebook for its Administrative Contracting Officers. It contains step-by-step processes for nearly all aspects of contract administration including terminations for convenience. *Id.*

<sup>18</sup> FAR, *supra* note 2, at 49.102(a); ONEBOOK, *supra* note 17, at 4.6.1.2.

<sup>19</sup> Telephone Interviews with Mr. Melvin Moe, Termination Contracting Officer, Defense Contract Management Agency, Defense Contract Management Command, Van Nuys, California (Jan 22, 2001 and Feb. 7, 2001)(notes on file with author).

<sup>20</sup> ONEBOOK, *supra* note 17, § 10.1, at para.4.6.3.

<sup>21</sup> *Id.* (implementing FAR, *supra* note 2, at 49.105(a)(1)).

<sup>22</sup> FAR, *supra* note 2, at 49.104(h).

<sup>23</sup> *Best Foam Fabricators, Inc. v. United States*, 38 Fed. Cl. 627, 638 (1997).

<sup>24</sup> Allowable cost: "A cost that the Government will permit to be recovered (reimbursed by the Government) for the performance of a contract." RALPH C. NASH, JR. & STEVEN L. SCHOONER, *THE GOVERNMENT CONTRACTS REFERENCE BOOK* 19 (1992).

<sup>25</sup> "A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business." FAR, *supra* note 2, at 31.201-3(a). This means that if a company spent money to pay to advertise on a bus bench, the cost would be reasonable if, for instance, the company's competitors also advertise on bus benches and that kind of advertising is necessary to bring in business that keeps the company going between Government contracts. Such a cost would fall within the definition of reasonable.

Most of the time, the TCO is already familiar with Part 31 and, in the case of settlement proposals under \$100,000,<sup>30</sup> the TCO can and often will decide allowability. If the termination settlement proposal is over \$100,000, then the TCO must forward the contractor's termination settlement proposal and all of the supporting accounting documentation to the Defense Contract Audit Agency (DCAA) for an audit.<sup>31</sup> The FAR considers the DCAA audit part of a TCO's field review of the contractor's settlement proposal.<sup>32</sup>

### C. The DCAA

The DCAA is an agency of the Department of Defense that is separate from the individual military services.<sup>33</sup> The DCAA sets out its purpose on the first page of its website:

The Defense Contract Audit Agency is under the authority, direction, and control of the Under Secretary of Defense (Comptroller), and is responsible for performing all contract audits for the Department of Defense. It also provides accounting and financial advisory services regarding contracts and subcontracts to all DoD components involved in procurement and contract administration.<sup>34</sup>

In a termination, the DCAA's responsibility is to audit the contractor's termination settlement and help determine whether costs are allowable or unallowable<sup>35</sup> based upon the Cost Accounting Standards (CAS) and FAR Part 31. What the DCAA field auditor generates in response to a termination

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<sup>26</sup> FAR, *supra* note 2, at 31.201-4. "A cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship." *Id.* This means that a cost is an amount spent to further the performance of a particular contract. For instance, the cost of a tank of gasoline in a company truck is allocable if that gas was burned to run errands exclusively for the contract to which the cost was "allocated."

<sup>27</sup> FAR, *supra* note 2, at 31.201-2(a)(3). The Cost Accounting Standards can also be thought of as, "A series of accounting standards originally issued by the Cost Accounting Standards Board to achieve uniformity and consistency in measuring, assigning, and allocating costs to contracts with the Federal Government." NASH & SCHOONER, *supra* note 24, at 105.

<sup>28</sup> FAR, *supra* note 2, at 31.201-2(a)(4).

<sup>29</sup> *Id.* at 31.201-2(a)(5).

<sup>30</sup> *Id.* at 49.107.

<sup>31</sup> *Id.*

<sup>32</sup> ONEBOOK, *supra* note 17, § 10.1, at para.4.6.8.

<sup>33</sup> See generally, Defense Contract Audit Agency, *Internet site*, at <http://www.dcaa.mil> (last visited July 19, 2002) [hereinafter *DCAA Website*].

<sup>34</sup> *Id.*

<sup>35</sup> The FAR defines unallowable cost as, ". . . any cost which, under the provisions of any pertinent law, regulation, or contract, cannot be included in prices, cost-reimbursements, or settlements under a Government contract to which it is allocable." FAR, *supra* note 2, at 31.001. NASH & SCHOONER, *supra* note 24, at 407, defines unallowable cost as "A cost incurred by a contractor that is not chargeable to Government contracts."

settlement audit request is called an “audit report.” An audit report will have a number of sections detailing the factors considered and the accounting rules and assumptions applied. Since audits are merely advisory,<sup>36</sup> the DCAA auditors do not tell the TCO that certain costs are unallowable: they “question” the costs. Thus, having submitted a termination settlement proposal to DCAA for audit, the TCO should expect to receive back a multi-page report that concludes that certain of the contractor’s proposed settlement costs are “questioned as being unallowable costs.”

Practice pointer: DCAA is independent from the military services and, therefore, is not subject to service-specific pressure in auditing terminations. The DCAA’s independence is generally a blessing, especially in situations where the command does not want to pay certain termination costs and the TCO feels they are allowable, or where the Government is using an auditor as an expert witness in a contract appeal. However, its independence can also be a hindrance when the TCO and DCAA auditor are at odds. When the TCO supports allowing a cost and the DCAA auditor thinks the TCO should disallow the cost, a conflict can create a situation in which the TCO asks the base-level contracts attorney to disprove the conclusions of the DCAA auditor’s attorney on certain costs.<sup>37</sup>

#### **D. Termination Settlement Negotiation**

After the TCO has received all of the field review information including a DCAA audit report, the TCO will prepare a prenegotiation position.<sup>38</sup> This is often the point at which a TCO will call the contracts attorney and ask for an opinion. The TCO will want the base contracts attorney to review the TCO’s position on allowable and unallowable costs and perhaps even attend the termination settlement negotiation. If the TCO requests assistance, the contracts attorney should carefully scrutinize any costs DCAA has questioned as unallowable. The contracts attorney should also realize that after the Government terminates its contract for convenience, a contractor is likely to believe that it is entitled to *all* of its costs—as opposed to just the *allowable* ones. When a contractor has this mindset, a disallowance by the TCO easily becomes contentious in the negotiation. Thus, it is important

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<sup>36</sup> See *DCAA Website*, *supra* note 33. Though the DCAA maintains that audits are merely advisory, in the author’s experience, TCOs consider the DCAA audit very convincing and rarely depart from their auditor’s recommendations.

<sup>37</sup> Such a situation can damage the Government’s case in a contract appeal, especially when the conflicting legal opinions look like the agency is arguing with itself. To prevent the internal conflict from surfacing in discovery, always make sure that attorney work product and attorney-client documents are properly labeled and segregated from the discoverable litigation documents. It is also a good idea to remind the DCAA attorney to do the same.

<sup>38</sup> ONEBOOK, *supra* note 17, § 10.1, at para. 4.6.9.

to fully understand DCAA's position in order to advise the TCO.<sup>39</sup> In addition, preparation for attending a termination settlement negotiation includes discussing with the TCO both the issues mentioned in the DCAA audit report and other foreseeable issues. It is possible that a contractor may have additional justifications for claimed costs and it may switch its argument mid-negotiation, hoping to catch the TCO unprepared.<sup>40</sup>

Once the termination settlement negotiation is complete, there are two possible outcomes: a bilateral agreement in which the parties have agreed on a termination settlement or a "settlement by determination."<sup>41</sup> A bilateral agreement on the termination settlement requires a Settlement Negotiation Memorandum<sup>42</sup> which the agency must review according to its procedures.<sup>43</sup> Neither the FAR nor DFARS requires legal review of the Settlement Negotiation Memorandum, but such review is advisable.<sup>44</sup>

If the termination negotiation proves to be fruitless, the TCO will issue a settlement by determination.<sup>45</sup> A settlement by determination not resulting from a contractor's failure to submit a termination settlement proposal is an appealable final decision for purposes of the Contract Disputes Act.<sup>46</sup> Thus, a

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<sup>39</sup> Advising the TCO also requires the application of business sense in addition to legal acumen. Often, a position taken by the TCO may be legally tenable, but the attorney should be sure to consider whether advising the TCO to take such a position is in the best interests of the Government overall.

<sup>40</sup> This happened to the author in a termination settlement negotiation in 1996. In the termination of a contract for chemical storage tanks, the contractor first proposed to try to recover some of its personnel costs in overhead costs (basically the cost of running the main office). When the TCO said that the contractor was not properly allocating (assigning to the correct contract) the costs, the contractor switched its argument to claiming those same costs as "unabsorbed overhead." Luckily, the TCO and attorney anticipated this argument and were prepared to deal with the issue of unabsorbed overhead. Despite the preparation, the settlement negotiation with this company still encompassed several meetings over the course of a year.

<sup>41</sup> Settlement by determination is a unilateral modification stating that the TCO is settling the termination for the amount the TCO has decided properly compensates the contractor for the termination.

<sup>42</sup> FAR, *supra* note 2, at 49.110. In the Department of Defense, the Settlement Negotiation Memorandum should be completed on a specific form prescribed in U.S. DEP'T OF DEFENSE, DEFENSE FEDERAL ACQUISITION REG. SUPP. 249.110 (1998)[hereinafter DFARS]; available at <http://farsite.hill.af.mil/Vfdfar.htm> (last visited July 19, 2002).

<sup>43</sup> FAR, *supra* note 2, at 49.111.

<sup>44</sup> The Air Force previously required all termination settlement agreements to have legal review per U.S. DEP'T OF THE AIR FORCE, AIR FORCE FEDERAL ACQUISITION REG. SUPP. 5349.109 (1996)[hereinafter AFFARS]. However, that requirement was rescinded in the AFFARS 2002 edition. Neither the Army nor the Navy has a legal review requirement.

<sup>45</sup> FAR, *supra* note 2, at 49.107(a): "General. If the contractor and the TCO cannot agree on a termination settlement, or if a settlement proposal is not submitted within the period required by the termination clause, the TCO shall issue a determination of the amount due consistent with the termination clause, including any cost principles incorporated by reference."

<sup>46</sup> FAR, *supra* note 2, at 49.109-7(f). The Contract Disputes Act is made available at FAR, *supra* note 2, Part 33, *et seq.*

contracts attorney should, before its issuance, review a settlement by determination for completeness<sup>47</sup> and fairness.<sup>48</sup>

### E. The Contractor Cost System

The FAR determines the overall procedure for conducting a termination for convenience. Thus, the TCO and the TCO's contracts attorney will be dealing primarily with FAR Part 49, Termination of Contracts. When the issue narrows to which costs are allowable in a convenience termination settlement, FAR 49.113 directs the parties to use the cost principles of FAR Part 31.<sup>49</sup> In interpreting FAR Part 31, military contracts attorneys have to look at precedent from the Armed Services Board of Contract Appeals (ASBCA), the United States Court of Federal Claims (COFC), and the Court of Appeals for the Federal Circuit (CAFC).<sup>50</sup> The ASBCA's position is that a termination for convenience effectively converts a fixed-price type contract into cost-reimbursement type contract.<sup>51</sup> The COFC takes the same position.<sup>52</sup>

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<sup>47</sup> The contents of a proper final decision are listed in the FAR, *supra* note 2, at 33.211. The Air Force requires all appealable proposed final decisions over \$100,000 to be forwarded to the ASBCA trial team, AFMCLO/JAB, for review before transmission. AFFARS, *supra* note 44, at 5333.211. Neither the Army nor the Navy has a similar requirement.

<sup>48</sup> A review for fairness should consider the TCO's conduct in the termination settlement as well as the amount the TCO has determined. Did the TCO negotiate even-handedly with the contractor? Did the TCO respond promptly and accurately to contractor calls and submissions? Does the TCO have good reasons for how he or she arrived at the amount of the settlement? These factors can dramatically affect the likelihood of litigation.

<sup>49</sup> FAR 49.113, states:

The costs principles and procedures in the applicable subpart of Part 31 shall, subject to the general principles in 49.201,

(a) Be used in asserting, negotiating, or determining costs relevant to termination settlements under contracts with other than educational institutions, and

(b) be a guide for the negotiation of settlements under contracts for experimental, developmental, or research work with educational institutions (*but see* FAR, *supra* note 2, at 31.104)

FAR, *supra* note 2, at 49.113.

<sup>50</sup> The ASBCA and the COFC are the two different entities to which a contractor can appeal a contracting officer's final decision. Both avenues of appeal are set out in the Contract Disputes Act, 41 U.S.C. § 601-613 (2002) and the process is applied to contractors through FAR Part 33 and the clauses of FAR 52.233. 41 U.S.C. § 606 states that a contractor can appeal to an Agency Board of Contract Appeals (the ASBCA here) within 90 days of a contracting officer's final decision. *Id.* 41 U.S.C. § 609 states that a contractor also has the option of appealing a final decision to the COFC within twelve months after the contractor receives the final decision. *Id.* The CAFC has appellate jurisdiction for both the Boards of Contract Appeals (including the ASBCA - 41 U.S.C. § 607(g)(1) (2002)) and the Court of Federal Claims (28 U.S.C. § 1295(a)(3) (2002)).

<sup>51</sup> Mandocdoc Const. Co., Inc., ASBCA No. 43,701, 1995 WL 431141, 95-2 B.C.A. (CCH) ¶ 27,800, (July 14, 1995) (citing Southland Mfg. Corp, ASBCA No. 16,830, 1974 WL 2026,

Therefore, the most important part of the termination process is applying Parts 30 and 31 cost principles to different types of contractor costs regardless of whether the terminated contract was fixed price or cost reimbursement

FAR Parts 30, Cost Accounting Standards Administration, and 31, Contract Cost Principles and Procedures, contain a number of rules, including Cost Accounting Standards (CAS), that govern how cost reimbursement contracts are accounted for and managed. The CAS are general accounting principles promulgated by the CAS Board,<sup>53</sup> detailing how contractors must maintain an accounting system and account for costs incurred on Government contracts. The contract cost principles are the actual rules describing the determination, negotiation, or allowance of costs when a contract clause requires such accounting.<sup>54</sup> It is the CAS and FAR Part 31 that DCAA uses in auditing a termination settlement and writing an audit report. Those rules are interpreted for DCAA in their internal audit guidance document, the DCAA Contract Audit Manual (CAM).<sup>55</sup>

### III. TERMINATION COSTS (FAR PART 31.205-42)

Having reviewed the basic procedures associated with convenience terminations and the agencies and personnel involved, let us revisit the original hypothetical about the Moab Industries termination. You go to visit the TCO to talk and have a look at the contract. Along with a copy of the proposed termination settlement, the TCO gives you a copy of the DCAA audit report for the case. After going through several pages of auditing assumptions made by the DCAA auditor, the audit concludes that the costs proposed by MI appear generally allowable with the exception of the following questioned costs:

- 1) FAR 31.205-42(a): The salvage cost<sup>56</sup> of titanium castings suitable for machining aircraft parts;

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75-1 B.C.A. (CCH) ¶ 10,994 , (Nov. 29, 1974), *recons. denied*, ASBCA No. 16,830, 1975 WL 1937, 75-1 B.C.A. (CCH) ¶ 11,272 (1975)).

<sup>52</sup> *Best Foam Fabricators*, 38 Fed.Cl. at 638.

<sup>53</sup> The Office of Federal Procurement Policy (OFPP) administers the CAS Board. Its five members are the Administrator of the OFPP, two Government representatives (one from General Services Agency and one from Department of Defense), and two private sector representatives (one representing industry and one cost accounting specialist). NASH & SCHOONER, *supra* note 24, at 106.

<sup>54</sup> FAR, *supra* note 2, at 31.000.

<sup>55</sup> U.S. DEP'T OF DEFENSE, DEFENSE CONTRACT AUDIT AGENCY CONTRACT AUDIT MANUAL, DCAAM 7640.1, (Jan. 2001)[hereinafter CAM]; available at <http://www.deskbook.osd.mil/> (last visited July 16, 2002).

<sup>56</sup> The FAR defines salvage as “. . . property that, because of its worn, damaged, deteriorated, or incomplete condition or specialized nature, has no reasonable prospect of sale or use as serviceable property without major repairs, but has some value in excess of its scrap value.” Salvage cost is the cost of something sold as scrap, as opposed to its true market value or depreciated value at the time of sale. See FAR, *supra* note 2, at 45.501.



2) FAR 31.205-42(b): The cost of the remaining four-month maintenance contract on the 5-axis machine tool used on the contract;

3) FAR 31.205-42(c): Employee safety training specific to the 5-axis machine tool MI used that was conducted prior to the start date of the contract;

4) FAR 31.205-42(d): The cost of an overhead rail system designed to transport the contract items throughout the plant;

5) FAR 31.205-42(e): The cost of the remaining fourteen months of MI's lease on the building in which it is located;

6) FAR 31.205-42(f): The cost of relocating floor anchors<sup>57</sup> for the 5-axis machine tool;

7) FAR 31.205-42(g): Attorney's fees for the preparation of the contractor's settlement proposal;

8) FAR 31.205-42(h): The cost of terminating MI's electronics subcontractor for convenience.

After reading the Audit Report, you scratch your head and wonder whom you can get to take this from you. As far as you can tell, these questioned costs are all specific to convenience terminations and it looks like there is very little case law or authoritative guidance to follow. Then you remember that you read a primer on "Termination Costs" awhile back that may prove a useful starting point for your analysis.

Most of the FAR Part 31 rules deal with cost reimbursement contracts. Because the general law surrounding cost accounting for cost reimbursement contracts is well established, this primer will not go into detail about those rules. Instead, the focus here will be on FAR Part 31.205-42, Termination Costs,<sup>58</sup> examining each type of termination cost and giving guidance that a contracts attorney can use to determine whether a particular cost is allowable.

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<sup>57</sup> For purposes of this hypothetical, assume large machine tools must be bolted to the floor to improve the accuracy of the machining and to prevent the vibration and forces generated from moving the entire machine tool across the shop.

<sup>58</sup> FAR, *supra* note 2, at 31.205. The subpart on termination costs states:

Contract terminations generally give rise to the incurrence of costs or the need for special treatment of costs that would not have arisen had the contract not been terminated. The following cost principles peculiar to termination situations are to be used in conjunction with the other cost principles in subpart 31.2.

*Id.*

### A. 31.205-42(a): Common Items<sup>59</sup>

As the name and the description suggest, common items are items the contractor can use in the “contractor’s other work.”<sup>60</sup> According to both federal court and BCA case law, the key parts of FAR 31.205-42(a) seem to be “reasonably usable on the contractor’s other work,”<sup>61</sup> and “could not be retained at cost without sustaining a loss.”<sup>62</sup>

#### 1. Reasonably Usable on the Contractor’s Other Work

In order to determine what is reasonably usable on the contractor’s other work, the CAM recommends looking at the contractor’s plans and orders for current or scheduled production and for current purchases of common items. It also recommends looking at the contractor’s entire stock and the ordering record of the item to see if the same item is being used for other contracts.<sup>63</sup> According to the ASBCA, a reasonably usable determination is a subjective determination from the contractor’s perspective dependent on the particular factual situation.<sup>64</sup> For instance, in a contract to supply clocks to the Government, the cost of clock bottom set rods procured for the terminated contract and used on another contract were considered reasonably usable, while the terminated contract’s 24-inch power cords were not because the current model clock designs used 36-inch cords.<sup>65</sup>

More often, “reasonably usable on the contractor’s other work” applies to items that are basic commodities used to perform a contract (e.g., the sand, cement, gravel, paint thinner, reflector paint and paint used on a roadway

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<sup>59</sup> *Id.* at 31.205-42(a). The section on common items reads:

*Common Items.* The costs of items reasonably usable on the contractor’s other work shall not be allowable unless the contractor submits evidence that the items could not be retained at cost without sustaining a loss. The contracting officer should consider the contractor’s plans and orders for current and planned production when determining if items can reasonably be used on other work of the contractor. Contemporaneous purchase of common items by the contractor shall be regarded as evidence that such items are reasonably usable on the contractor’s other work. Any acceptance of common items as allocable to the terminated portion of the contract should be limited to the extent that the quantities of such items on hand, in transit and on order are in excess of the reasonable quantitative requirements of other work. *Id.*

<sup>60</sup> *Id.*

<sup>61</sup> *Id.*

<sup>62</sup> *Id.*

<sup>63</sup> CAM, *supra* note 55, at 12-304.5(b).

<sup>64</sup> *Southland Mfg.*, ASCBA No. 16,830, ¶ 11,272 at 52,356 (holding items not “reasonably usable” in manufacturing contract where the contractor had no other work despite efforts to obtain other work).

<sup>65</sup> *Franklin Instrument Co., Inc.*, GSBCA No. 7497, 1985 WL 16362, 1985 GSBCA LEXIS 744, at 13 (Jan 11, 1985).

repaving contract.)<sup>66</sup> Common items can be finished items such as uniforms and radios,<sup>67</sup> shelves,<sup>68</sup> or office furniture.<sup>69</sup> Common items can also be large, expensive items that were either manufactured,<sup>70</sup> or leased by the contractor.<sup>71</sup> For large, expensive items, one test used to determine “reasonably usable in the contractor’s other business” is whether the contractor could sell, lease or operate the item when an opportunity arose.<sup>72</sup> In at least one other case, a large expensive item was not considered a common item because it could not be sold or leased (“reasonably used”) to defray the contractor’s expenses after termination.<sup>73</sup>

## 2. *Could Not be Retained at Cost Without Sustaining a Loss*

The second part of an analysis of whether items claimed by a contractor are, in fact, common ones examines whether the contractor could retain the items at cost without sustaining a loss. This portion of the analysis is not always considered in the Board opinions, but when the Boards have considered it, they have looked at whether the contractor, in fact, had other work on which it could use the claimed common items.<sup>74</sup> This analysis appears to be a snapshot of the contractor at the time, not necessarily looking at whether, in the future, the contractor would have contracts on which it could use the common items. In most cases, “retained at cost without sustaining a loss” means that a common item will not cost the contractor something to retain after the termination. For instance, if the common item in question is a load of steel that the contractor can immediately use on other contracts without having to pay any storage fees, it may be a noncompensable common item. However, if the

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<sup>66</sup> Joint Venture G.C.D. *et al.*, ASBCA No. 47,285, 1997 WL 217391, 97-1 B.C.A. (CCH) ¶ 28,976 (1997).

<sup>67</sup> Mid-Atlantic Sec. Servs., Inc., ENGBCA No.6,302, 97-2 B.C.A. (CCH) ¶ 29,012 (1997).

<sup>68</sup> Hugo Auchter GmbH, ASBCA No. 39,642, 1991 WL 27067, 91-1 B.C.A. (CCH) ¶ 23,645, (Feb 15, 1991).

<sup>69</sup> McDonnell Douglas Corp. v. United States, 40 Fed.Cl. 529, 552 (1998), *rev'd on other grounds*, 182 F.3d 1319 (Fed.Cir., 1999).

<sup>70</sup> Orbital Sciences Corp., ASBCA No. 49,250, 1997 WL 606986, 97-2 B.C.A. (CCH) ¶ 29,265 (1997); *aff'd on recons.*, ASBCA No. 49,250, 1998 WL 601096, 98-2 B.C.A. (CCH) ¶ 29,994 (1998) (finding that rocket motors manufactured by appellant were common items).

<sup>71</sup> Globe Air, Inc., AGBCA No. 76-119, 1978 WL 23536, 78-1 B.C.A. (CCH) ¶ 13,079 (Ag.B.C.A., Mar. 20, 1978)(finding that the helicopter procured as a replacement for contract aircraft that had crashed was a common item because the contractor could sell, lease or operate it when an opportunity arose).

<sup>72</sup> *Id.*

<sup>73</sup> *Fiesta Leasing and Sales, Inc.*, ASBCA No. 29,311, 1987 WL 40637, 87-1 B.C.A. (CCH) ¶ 19,622 (1987).

<sup>74</sup> *See e.g. Southland*, ASBCA No. 16,830, ¶ 10,994 at 52,356 (finding that the contractor could not retain the disputed common items at cost without sustaining a loss because it had no other contracts on which to use the items, and despite “major effort” was unable to obtain other work.); *Fiesta Leasing and Sales, Inc.*, ASBCA No. 29,311, ¶ 19,622 at 99,286-87.

contractor takes a loss on reuse or incurs costs for storage of the steel, then it cannot be “retained at cost without sustaining a loss” and the contractor may be able to claim the costs as termination costs.

In the case of usable “items,” (e.g., buses), the courts and boards have established a different definition of “retained at cost without sustaining a loss”: even though certain contractor items continue to be used by the contractor, if the allowable costs on the items (such as lease expense) are less than the revenue generated by the other use (such as rental fees from other companies), they are “retained at cost without sustaining a loss.”<sup>75</sup> For items that have to be scrapped, the “cost” of the items is the depreciated cost value, less the salvage value.<sup>76</sup> Diminution of profit is not a “loss” for common items that are reused by a contractor.<sup>77</sup>

### 3. Hypothetical Analysis

Let us return to the hypothetical about the titanium castings. If the contractor has other contracts (Government or commercial) on which it can use the castings, then that stock would likely be considered common items and not be reimbursable through the termination settlement. However, if the terminated contract was the contractor’s only work and the termination put it out of business, then the castings would not be common items and would be reimbursable. How much would the contractor get? Answer: purchase cost (or depreciated value, if the items depreciated) less salvage value.

#### **B. 31.205-42(b): Costs Continuing After Termination**<sup>78</sup>

This category of costs represents those costs a contractor has incurred or agreed to pay in performance of the contract that could not necessarily be stopped immediately upon notification that the Government had terminated the contract. “Continuing costs,” as they are called, are often misunderstood and

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<sup>75</sup> *Fiesta Leasing and Sales, Inc.*, ASBCA No. 29,311, ¶ 19,622 at 99,287 (holding as allowable the costs for buses leased for a contract that exceeded the revenue generated by the buses during and after the terminated contract).

<sup>76</sup> *Id.* at 99,288.

<sup>77</sup> *Symetrics Indus., Inc.*, ASBCA No. 48,529, 1996 WL 189675, 96-2 B.C.A. (CCH) ¶ 28,285 (A.S.B.C.A., Apr. 8, 1996) (holding telemetry sets were common items and loss of quantity discount resulting from use on other contract not a “loss.”); *Orbital Sciences*, ASBCA No. 49,250, ¶ 29,265 at ¶49,804 (disallowing loss of profit on other contract resulting from having used common items (rocket motors) (citing *Symetrics Indus.*, ASBCA No. 48,529 and *Fiesta Leasing and Sales, Inc.*, ASBCA No. 29,311, ¶ 19,622).

<sup>78</sup> FAR, *supra* note 2, at 31.205-42(b) states:

Despite all reasonable efforts by the contractor, costs which cannot be discontinued immediately after the effective date of termination are generally allowable. However, any costs continuing after the effective date of the termination due to the negligent or willful failure of the contractor to discontinue the costs shall be unallowable.

contractors consider the continuing costs provision a catchall provision for costs that do not seem to fit in other categories of termination costs.<sup>79</sup> As such, FAR 31.205-42(b) costs are frequently challenged by the DCAA auditors and litigated by contractors.<sup>80</sup>

At the most fundamental level, continuing costs are those a contractor incurs as a result of performing terminated work or that flow from termination.<sup>81</sup> The DCAA's focus in evaluating allowability of continuing costs is on the termination date: did the contractor continue to incur the claimed cost after the effective date of the termination?<sup>82</sup> The CAM states "reasonable costs associated with termination activities are allowable," for instance, the salary or wage costs of contract personnel at a remote site, or of personnel in transit that have to be diverted to other non-terminated work, can be allowable.<sup>83</sup> The CAM also provides the example that costs involving items that are in the midst of a process (such as electroplating or heat-treatment) may be allowable where stopping the process would make these items significantly less valuable to the Government post-termination.<sup>84</sup>

Courts and boards consider the continuing costs provision a "vehicle by which certain post-termination costs may be recovered absent specific authority therefore . . . [which] furnishes a means by which the Government can provide fair compensation on a case by case basis within the regulatory scheme."<sup>85</sup> Thus, they have not necessarily developed a specific test to apply to continuing costs. Instead, the courts and boards appear to look at the fairness and facts of each case individually. Nonetheless, the cases can be divided into three basic types: personnel, facilities, and unabsorbed overhead.

### *1. Personnel Cases*

In performing a contract, there are invariably contractor personnel the contractor hired for that contract or diverted from another Government or commercial contract to work on the terminated contract. If a contractor lays an employee off as a result of the contract termination, the contractor may charge severance pay as continuing costs.<sup>86</sup> However, the contractor must be able to prove that the costs are applicable to specific employees or the severance pay

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<sup>79</sup> See ALLAN JOSEPH & NEIL O'DONNELL, *TERMINATION OF GOVERNMENT CONTRACTS*, XII-1 (1991).

<sup>80</sup> Telephone Interviews with Mr. Mel Moe, *supra* note 19.

<sup>81</sup> CIBINIC & NASH, *supra* note 1, at 1106 (citing Aviation Specialists, Inc., 1990 WL198291, 02-1 B.C.A. (CCH) ¶ 31,788, 91-1 B.C.A. (CCH) ¶ 23,554 (D.O.T.C.A.B., Dec 03, 1990)).

<sup>82</sup> CAM, *supra* note 55, at 12-305.7(a).

<sup>83</sup> *Id.* at 12-305.7(a)(1).

<sup>84</sup> *Id.*

<sup>85</sup> JOSEPH & O'DONNELL, *supra* note 79, at XII-1-2.

<sup>86</sup> *Globe Air, Inc.*, AGBCA No. 76-119, ¶ 13,079 (holding pilot's salary that continued for 2 weeks past termination was severance and was allowable).

will not be allowed.<sup>87</sup> If the contractor did not lay off an employee but the employee was validly working on the termination effort, his or her salary will be allowable.<sup>88</sup> The source of the obligation to pay an employee does not seem to matter: it can be a contractual obligation or an obligation required by local law.<sup>89</sup> Finally, continuing costs do not have to be direct payments of salary or severance pay, they can also be reimbursement to the employee for incidental expenses such as relocation.<sup>90</sup> The bottom line on continuing costs for personnel is that they must have been involved in the termination or the obligation to pay them must have arisen from a contractual or legal obligation and be properly documented. Otherwise, continuing costs for personnel will not be allowable.

## 2. Facilities Cases

In contracts involving the delivery of goods or services, contractors often seek to use FAR 31.205-42(b) to recover the continuing costs of contractor-leased facilities or machinery and equipment. Because of the fairly broad definition of continuing costs, termination costs that are not recoverable under FAR 31.205-42(d), Loss of Useful Value, and FAR 31.205-42(e), Rental Costs, may be recoverable as continuing costs. An example of a cost that is recoverable as a continuing cost is depreciation. For example, the Department of Transportation Board of Contract Appeals (DOTBCA) has held that, following the convenience termination of an aircraft use requirements contract, the contractor was entitled to depreciation, maintenance costs, the cost of facilities capital, general and administrative expenses and advertising between the termination date and the date the contract would have ended.<sup>91</sup> The DOTBCA supported this finding by reasoning that the costs could not have reasonably been discontinued immediately despite the company's best efforts to mitigate.<sup>92</sup>

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<sup>87</sup> TDC Mgmt Corp., DOTBCA No. 1802, 1991 WL 105566, 91-3 B.C.A. (CCH) ¶ 24,091, 120,572 (D.O.T.C.A.B., 1991). (holding \$3905 in severance costs for 3 employees not allowable because there was no evidence regarding those employees); Mid-Atlantic Sec. Servs., Inc., No. 6,302, 97-2 B.C.A. (CCH) ¶ 29,012 (E.N.G.B.C.A., 1997) (holding full payroll costs of supervisors that contractor retained but did not reassign to other work not recoverable absent proof they did work on termination).

<sup>88</sup> TDC, DOTBCA No. 1802 ¶ 24,061 at ¶ 120,572 (continuing costs claim for employee that expended 275 hours after termination was allowable).

<sup>89</sup> R&B Bewachungs GmbH, ASBCA No. 42214, 1992 WL 115141, 92-3 B.C.A. (CCH) ¶ 25,105, 125,156 (May 26, 1992) (holding employees' pay past termination date was allowable where German law required security guards to receive pay).

<sup>90</sup> In at least one case, the COFC has ruled that the cost of relocating employees because of a termination is allowable under FAR 31.205-42(b). See *McDonnell Douglas*, 40 Fed.Cl. at 552.

<sup>91</sup> *Aviation Specialists*, DOTBCA No. 1967, ¶ 23,554 at 117,993.

<sup>92</sup> *Id.* See also, *Fiesta Leasing and Sales, Inc.*, ASBCA No. 29,311, ¶ 19,622 at 99,289 (holding depreciation cost and advertising cost allowable as continuing costs of the

Mitigation by ceasing to incur costs appears to be a key factor to allowability of continuing costs, because where a contractor fails to make reasonable efforts to discontinue incurring costs related to the terminated contract, the BCAs refuse to allow the costs. In a recent case, the ASBCA sustained disallowance of four months' post-termination costs for office rental, land rental, labor, and excavator rental after the contractor failed to make efforts to discontinue the costs.<sup>93</sup>

### 3. *Unabsorbed Overhead*

The sure way to have a cost claim disallowed is to call it, or have a BCA call it, continuing overhead or unabsorbed overhead.<sup>94</sup> Boards have consistently sustained disallowance of continuing cost claims that are for unabsorbed overhead for a period past the termination date.<sup>95</sup> Even where the contractor has argued that an improper convenience termination prevented it from entering into any contracts by which to absorb its indirect costs, the Boards still have not allowed unabsorbed overhead.<sup>96</sup> The only relief has been for a contractor to claim that some costs, such as rental, utility and insurance, could not reasonably have been shut off at the time a termination rendered the plant completely useless.<sup>97</sup>

### 4. *Hypothetical Analysis*

Looking at the hypothetical claimed cost for the remaining four-month maintenance contract on the 5-axis machine tool used on the contract, a contracts attorney must consider whether the cost had to be continued past termination. If the contractor could have stopped incurring the cost at the time of contract termination, then a claim for continuing costs for maintenance will not be allowable. By contrast, if the cost was necessary to maintain the value of the machine tool, was not transferable or terminable by the contractor, and

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termination). *But see, Southland*, ¶ 29,265 at ¶ 52,359 (holding contractor interest due on equipment loans not allowable as continuing cost of termination).

<sup>93</sup> *Joint Venture G.C.D.*, ASBCA No. 47,285, ¶ 28,976 at 144,310-11 (holding that overhead costs such as office rental, land rental, labor and excavator rental were not allowable because the contractor failed to make an effort to discontinue the costs).

<sup>94</sup> “Unabsorbed overhead is overhead that cannot be charged to a contract as originally anticipated because the direct costs of performance have been stopped due to a delay.” NASH & SCHOONER, *supra* note 24, at 407.

<sup>95</sup> *Southland*, ASBCA No. 16,830, ¶ 10,994 at 52,360 (citing Chamberlain Mfg. Corp., ASBCA No. 16,877, 1973 WL 1882, 73-2 B.C.A. (CCH) ¶ 10,139, 47,679 (June 22, 1973)).

<sup>96</sup> *Foremost Mechanical Sys., Inc.*, GSBCA Nos. 13250-C(12335), 13251-C(12384), 13252-C(12527), 13584, 1998 WL 148412 (G.S.B.C.A.), 98-1 B.C.A. (CCH) ¶ 29,652, 146,922 (Mar. 31, 1998).

<sup>97</sup> *Baifield Indus., Div. of A-T-O, Inc.* ASBCA No. 20,006, 1976 WL 25,427, 76-2 B.C.A. (CCH) ¶ 12,096, 58,091 (1976) (holding continuing costs for rent, utilities and insurance allowable where contractor was making diligent efforts to dispose of the facility).

the contractor could not otherwise have mitigated, then the cost is likely allowable.

### C. 31.205-42(c): Initial Costs<sup>98</sup>

At its most fundamental level, FAR 31.205-42(c) allows a terminated contractor to recover the early-on, preparatory costs it expended in initiating performance that it will not recover entirely because the termination prevented it from manufacturing or supplying the full quantity of contract items. The need to compensate for initial costs is best shown by an example:

The Government awards a contract to Aim High, Inc. for 500 widgets at \$1000 each (\$500,000 for the whole contract). Widgets' cost per item to produce the entire contract amount is \$800 per unit for a total profit of \$100,000. Assume the total cost to set up machinery, train the workers, and let them do a number of practice runs to learn how to build the item quickly is \$50,000. When the Government terminates the contract at 300 widgets, the contractor's profit would only be \$40,000, not the \$60,000 that you would expect from a termination of the contract at 300 units. The balance sheet looks something like this:

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<sup>98</sup> FAR, *supra* note 2, at 31.205-42(c) states:

(c) Initial costs. Initial costs, including starting load and preparatory costs, are allowable as follows:

(1) Starting load costs not fully absorbed because of termination are nonrecurring labor, material, and related overhead costs incurred in the early part of production and result from such factors as-

- (i) Excessive spoilage due to inexperienced labor;
- (ii) Idle time and subnormal production due to testing and changing production methods;
- (iii) Training; and,
- (iv) Lack of familiarity or experience with the product, materials, or manufacturing processes.

(2) Preparatory costs incurred in preparing to perform the terminated contract include such costs as those incurred for initial plant rearrangement and alterations, management and personnel organization, and production planning. They do not include special machinery and equipment and starting load costs.

(3) When initial costs are included in the settlement proposal as a direct charge, such costs shall not also be included in overhead. Initial costs attributable to only one contract shall not be allocated to other contracts.

(4) If initial costs are claimed and have not been segregated on the contractor's books, they shall be segregated for settlement purposes from cost reports and schedules reflecting that high unit cost incurred during the early stages of the contract.

(5) If the settlement proposal is on the inventory basis, initial costs should normally be allocated on the basis of total end items called for by the contract immediately before termination; however, if the contract includes end items of a diverse nature, some other equitable basis may be used, such as machine or labor hours.



**Full Performance**

**Termination at 300 Units**

*Contract Payment*

<u>Units</u>	<u>Price</u>	<u>Total</u>
500	1000	500,000

<u>Units</u>	<u>Price</u>	<u>Total</u>
300	1000	300,000

*Manufacturing Cost (with Initial Costs)*

<u>Units</u>	<u>Price</u>	<u>Total</u>
500	700	[350,000]
Initial costs		[50,000]

<u>Units</u>	<u>Price</u>	<u>Total</u>
300	700	[210,000]
Initial Costs		[50,000]

<u>Cost Subtotal</u>	<u>[400,000]</u>
Profit	100,000
Profit per unit	<b><u>200</u></b>
Profit Rate	(20%)

<u>Cost Subtotal</u>	<u>[260,000]</u>
Profit	40,000
Profit per unit	<b><u>133</u></b>
Profit Rate	(13%)

Clearly the inequity is that the startup costs, if not covered by the termination, would cause the contractor profit margin to be lower because of the termination. Thus, FAR 31.205-42(c) makes these costs allowable. While allowability of these costs may be clear, the contractor’s and TCO’s conflict is over how to calculate the initial costs.

The DCAA states that contractors “rarely segregate initial costs in their formal records of books of account . . .”<sup>99</sup> Thus, the CAM recommends looking at high unit costs at the outset of the contract.<sup>100</sup> Those high unit costs can be found in informal records, cost reports, production data and other documents.<sup>101</sup> The CAM also says that an auditor can determine initial costs from the rate of production loss at the outset of the contract as reflected in the scrap reports, efficiency reports and spoilage tickets.<sup>102</sup> Once an auditor identifies costs, the hard part is assigning the initial costs to the terminated and nonterminated parts of the contract.<sup>103</sup> Needless to say, this part of determining initial costs is very evidence intensive and a contracts attorney without an accounting background should defer to the DCAA auditor’s position if well supported.

When initial costs are hard to calculate because a contractor has not kept detailed records of costs incurred in training the workforce, the BCAs

<sup>99</sup> CAM, *supra* note 55, at 12-305.1(b)(2).

<sup>100</sup> *Id.*

<sup>101</sup> *Id.*

<sup>102</sup> *Id.* at 12-305.1(c).

<sup>103</sup> *Id.* at 12-305.1(e).

have consistently used a learning curve analysis.<sup>104</sup> The learning curve analysis involves calculating an amount for learning costs by applying a mathematical formula to the labor costs booked during performance.<sup>105</sup> The only twist to learning curve cases appears to be this: where the contractor recovers initial costs associated with learning on one terminated contract, the Government is not entitled to a reduction in unit prices on a subsequent contract for the same items that benefited from the learning.<sup>106</sup> A smart contracts attorney will often understand the process, but leave the calculations to DCAA, remembering that because the calculation uses labor costs over the course of performance, the initial cost calculation will appear to involve labor costs up to the date of termination.<sup>107</sup>

An issue frequently encountered in initial cost claims is first article costs. A first article is a first item required by the Government in a contract for testing to confirm that the contractor can produce the item in accordance with contract requirements.<sup>108</sup> The first article issue comes into play when the contractor submits a first article, but the Government terminates the contract before any further items are manufactured. According to the Boards, the termination costs associated with submission of first articles are allowable as initial costs if the first articles pass the testing and the Government accepts them.<sup>109</sup>

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<sup>104</sup> *Sierracin/Sylmar*, ASBCA Nos. 27,531, 30,380, 1985 WL 16,589, 85-1 B.C.A. (CCH) ¶ 17,875, 89,549 (Jan. 22, 1985) explains the theory behind learning curve analysis:

The general theory of learning curves is that with repetitive tasks involving a considerable amount of labor, the speed or efficiency with which the task is performed increases as the number of units of the work increases. In general theory, as quantities double, learning is in the same ratio. Stated mathematically and assuming an 80 percent learning curve, this would mean that as the item quantities double the number of labor hours necessary to produce a unit would be 80 percent of the labor hours necessary to make the original unit; that if the first unit took 100 hours, the second unit would take 80 hours, the fourth unit would take 64 hours (80 percent of 80 hours), and the eighth unit 51.2 hours (80 percent of 80 percent of 80 hours), and so on.

<sup>105</sup> *Lockley Mfg. Co.*, ASBCA No. 21231, 1978 WL 2708, 78-1 B.C.A. (CCH) ¶ 12,987, 63,319 (Jan. 26, 1978).

<sup>106</sup> *Sierracin/Sylmar*, ASBCA Nos. 27,531, 30,380, ¶ 17,875 at 89,551.

<sup>107</sup> *Lockley*, ASBCA No. 21,231, ¶ 12,987 at 63,319 (holding it was proper to use labor costs up to termination to calculate the labor learning allocable to terminated units).

<sup>108</sup> The Government will often not provide contractors with a production release until first article testing is successfully completed. Nonetheless, contractors often begin incurring costs in preparation of full-scale production even before the production release to be able to meet the required delivery schedule.

<sup>109</sup> *Balimoy Mfg. of Venice, Inc.*, ASBCA Nos. 47,140, 48,165, 1998 WL 655472, 98-2 B.C.A. (CCH) ¶ 30,017, 148,512 (Sep. 23, 1998) (holding first article costs allowable in termination of contract for ammunition but failure to segregate the costs specific to first article prevented recovery); *Agrinautics*, ASBCA Nos. 21,512, 21,608, 21,609, 1980 WL 120474, 79-2 B.C.A. (CCH) ¶ 14,149, 69,649 (1980) (holding first article costs allowable for helicopter-mounted insecticide duster that had been given first article approval).

Further, costs attributable to contract quantities produced before first article acceptance may also be allowable.<sup>110</sup>

Beyond the costs of learning and first articles, contractors have recovered initial costs, unabsorbed training costs,<sup>111</sup> phone costs associated with calling overseas suppliers,<sup>112</sup> the cost of being put on a buyers' waiting list,<sup>113</sup> and the cost of painting a bus, delivering the bus and installing new tires.<sup>114</sup> Regarding when the initial costs can commence, the factors appear to be the type of contract and the contractor's intent. One BCA has allowed a conscientious contractor's initial costs incurred prior to award of the contract,<sup>115</sup> while another BCA has disallowed initial costs incurred by a contractor while awaiting a work order.<sup>116</sup>

### *Hypothetical Analysis*

So is employee safety training specific to the MI's 5-axis machine tool conducted prior to the start date of the contract allowable? Assuming that the first article was approved prior to the termination, and assuming that there are no other contracts that the employees worked on, the costs of the safety training would be allowable as initial costs incurred in preparation for performing the contract. If the first article was not approved, or the contractor had not properly segregated the costs, then they might not be allowable.

### **D. 31.205-42(d): Loss of Useful Value**

Loss of useful value,<sup>117</sup> like continuing costs, *supra*, is often a hotly contested subcategory of termination costs.<sup>118</sup> The language of the rule is

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<sup>110</sup> *Agrinautics*, ASBCA Nos. 12,512, 21,608, 21,609, ¶14,149 at 69,650.

<sup>111</sup> *R&B Bewachungs*, ASBCA No. 42,214, ¶ 25,105 at 125,157.

<sup>112</sup> *Hugo Auchter*, ASBCA No. 39,642, ¶ 23,645 at 118,442.

<sup>113</sup> *Fiesta Leasing and Sales, Inc.*, ASBCA No. 29311, ¶ 19,622 at 99,289-90.

<sup>114</sup> *Id.* at 99,289-90.

<sup>115</sup> *RHC Construction*, IBCA No. 2083, 88-3 B.C.A. (CCH) ¶ 20,991, 106,061 (1988).

<sup>116</sup> *Air-Flo Cleaning Sys.*, ASBCA No. 39,608, 1990 WL 132887, 90-3 B.C.A. (CCH) ¶ 23,071, 115,844 (June 22, 1990). *But see* *Teague Indus. & Technical Servs Co.*, ASBCA Nos. 29,230, 29,642, 1986 WL 19704, 86-2 B.C.A. (CCH) ¶ 18,790, 94,669 (Feb. 13, 1986) (holding cost of retaining employee to be ready for open orders allowable).

<sup>117</sup> FAR, *supra* note 2, at 31.205-42(d) states:

Loss of useful value. Loss of useful value of special tooling, special machinery and equipment is generally allowable, provided-

- (1) The special tooling, or special machinery and equipment is not reasonably capable of use in the other work of the contractor;
- (2) The Government's interest is protected by transfer of title or by other means deemed appropriate by the contracting officer; and
- (3) The loss of useful value for any one terminated contract is limited to that portion of the acquisition cost which bears the same ratio to the total acquisition cost as the terminated portion of the contract bears to the entire

fairly clear, but one of the key terms, “special machinery and equipment,” is left undefined by the FAR.<sup>119</sup> The lack of definition leaves that phrase wide open to interpretation by contractors seeking to recover the costs of equipment purchased for a later-terminated contract.

On its face, this loss of useful value provision allows reimbursement for costs of special tooling (ST)<sup>120</sup> and special machinery and equipment (SME) that was purchased or modified for the specific, terminated contract. Simplifying and rephrasing FAR 31.205-42(d), the ST or SME must: 1) not have been reasonably usable on the contractor’s other work; 2) have been given to the Government (through title transfer); and, 3) if the ST or SME was used for non-terminated contracts, have only the proportional lost value that relates to the terminated contract claimed. This provision has the greatest effect on terminated fixed-price contracts where the contractor has factored the cost of ST and SME into the unit prices through the end of the production. When the Government terminates the contract, this provision allows the contractor to recoup the ST and SME costs that it could not recoup through the prices on the full production run.

The CAM recognizes that loss of useful value determinations are often challenged, noting that they are “usually a technical matter.”<sup>121</sup> It then suggests that a legal opinion as to the intent of the parties regarding the SME may be necessary.<sup>122</sup> The manual also tells DCAA auditors not to consider machinery or equipment SME when it is ordinary equipment in the contractor’s industry, it is similar to other facilities owned by a contractor, or it is usable on the contractor’s other work without loss.<sup>123</sup>

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terminated contract and other Government contracts for which the special tooling or special machinery and equipment was acquired.

<sup>118</sup> Claims for loss of useful value can reach into the hundreds of millions of dollars. One example is a major contract termination for which the author was contracts attorney in 1996-7: within the contractor’s termination settlement proposal was a nearly \$200 million claim for loss of useful value of a custom-built production facility in Georgia.

<sup>119</sup> CIBINIC & NASH, *supra* note 1, at 1111. The Defense Acquisition Regulation and Federal Procurement Regulation, predecessors to the FAR, each contained a definition of special machinery and equipment. According to the Defense Acquisition Regulation, “Special machinery and equipment means that part of plant equipment which was acquired or constructed solely for the performance of the terminated contract or the terminated contract and other Government contracts, and as to which the contractor claims loss of useful value. 32 CFR § 8-101.21 (1981). The Federal Procurement Regulation used the same definition, “‘Special machinery and equipment’ means that part of plant equipment which was acquired or constructed solely for the performance of the terminated contract or the terminated contract and other Government contracts, and as to which the contractor claims loss of useful value.” 41 CFR § 1-8.101(t) (1980).

<sup>120</sup> FAR, *supra* note 2, at 31.205-40.

<sup>121</sup> CAM, *supra* note 55, at 12-304.14(a).

<sup>122</sup> *Id.* at 12-304.14(a).

<sup>123</sup> *Id.* at 12-304.14(a)(1-3).

What is not considered by the FAR, but is clear from the case law, is that the intent of the parties can be a key factor in determining the allowability of SME. If the parties intended the contractor to purchase the SME to perform the contract, the contractor likely can recover the cost of the lost value upon termination.<sup>124</sup> If the parties did not intend the contractor to purchase a particular type of equipment, the equipment will likely not be SME unless it truly is “special” in the sense that it cannot be used in the contractor’s other work and has no use to any other contractors in the industry.

### *1. Standard Analysis Cases*

The underlying principle for all situations where a convenience termination deprives an item of its useful life is that the Government should pay the full amount otherwise due for any items whose useful life becomes zero upon termination.<sup>125</sup> “Useful life” appears to be contractor-specific, because equipment that could not be used by one contractor on other work but could be used by other contractors has been considered SME.<sup>126</sup> Examples of items usable by others but allowed as SME are washing machines,<sup>127</sup> machine tools,<sup>128</sup> and a wire-braiding machine.<sup>129</sup> Special Machinery and Equipment status has not generally been extended to non-specialized types of machinery and equipment because it is reasonably usable after termination of the contract. In particular, the BCAs consistently refuse to find that computers<sup>130</sup> and furniture<sup>131</sup> qualify as SME.<sup>132</sup>

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<sup>124</sup> *Id.* at 12-304.14(b).

<sup>125</sup> TERA Advanced Sys. Corp., GSBCA No. 6,713-NRC, 85-2 B.C.A. (CCH) ¶ 17,940 (1985) (holding cost of custom-designed document retrieval carousel system allowable once system was established as valueless upon termination) (citing American Elec., Inc., ASBCA No. 16,635, 1976 WL 2409, 76-2 B.C.A. (CCH) ¶ 12,151 (1976) and Metered Laundry Servs., Inc., ASBCA No. 21,573, 1978 WL 2351, 78-1 B.C.A. (CCH) ¶ 13,206 (1978)).

<sup>126</sup> *American Elec.*, ASBCA No. 16,635 ¶ 12,151.

<sup>127</sup> *Metered Laundry*, ASBCA No. 21,573, ¶ 13,206.

<sup>128</sup> Ralcon, Inc., ASBCA No. 43,176, 1994 WL 228181, 94-2 B.C.A. (CCH) ¶ 26,935 (1994).

<sup>129</sup> Tubergen & Assocs., Inc., ASBCA Nos. 34,106, 34,107, 1990 WL 85435, 90-3 B.C.A. (CCH) ¶ 23,058, 115,766 (June 11, 1990).

<sup>130</sup> Greer, ENGBCA No. 6,283, 1997 WL 305917, 97-2 B.C.A. (CCH) ¶ 29,013 (June 6, 1997); Qualex Int’l, ASBCA No. 41,962, 1992 WL 319583, 93-1 B.C.A. (CCH) ¶ 25,517, 127,090 (Oct. 21, 1992); *Hugo Auchter*, ASBCA No. 39642, ¶ 23,645 at 118,444.

<sup>131</sup> *Greer*, ENGBCA No. 6,283, ¶ 29,013 at 144,548; *Qualex Int’l*, ASBCA No. 41,962, ¶ 25,517 at 127,090. *But see, McDonnell Douglas*, 40 Fed.Cl. at 552 (holding allowable loss of useful value for furniture).

<sup>132</sup> Other equipment not considered allowable as special machinery and equipment under FAR 31.205-42(d) include: a lathe (Teems, Inc., GSBCA No. 14,090, 1997 WL 687905, 98-1 B.C.A. (CCH) ¶ 29,357, 145,962 (Oct. 31, 1997)); a wrapping machine (*Dairy Sales Corp. v. U. S.*, 593 F.2d 1002, 1006 (Ct.Cl. 1979)); and commercial mowers (*Greer*, ENGBCA No. 6,283, ¶ 29,013 at 144,548).

The distinction between many of these cases is hard to draw. The most consistent analysis appears to be that the Boards look at the standard factors of FAR 31.205-42(d): 1) reasonably capable of use in other work; 2) title offered to the Government; 3) cost proportional to use on terminated contract; and then, if the equipment is *arguably* SME, the Boards look at the reasonableness of the CO's decision. Where the CO's decision is very unfair, the Board is more likely to find the loss of useful value allowable.<sup>133</sup>

## 2. Intent of the Parties

The most frequently cited case on loss of useful value is *American Electric*.<sup>134</sup> The case represents the broadest expansion of what FAR 31.205-42(d) allows to be compensated. In *American Electric*, the Government issued a letter contract to American Electric, Inc. to develop a munitions manufacturing capability quickly. The contractor conducted a thorough search for facilities it could use, but having found none, determined that it would have to purchase land and construct facilities. The facilities it constructed were special facilities for high-risk smelting and grinding of explosive materials, so the contractor had to incorporate many safety features into the design of the buildings at extra cost. All of the manufacturing equipment was custom designed and built for this contract and the contractor discussed the proposed actions regarding manufacturing equipment and facilities at length with the contracting officer. Upon appeal of disallowance of the costs, the ASBCA applied a straightforward analysis of the loss of useful value factors. However, it held that loss of useful value applied to the special machinery and equipment, *as well as* the buildings and other facilities. Of course, buildings and other facilities are well beyond the broadest definition of SME. However, the ASBCA seemed to imply that the intent of the parties regarding their necessity justified treating them as SME.<sup>135</sup> In this way, FAR 31.205-42(d) seems to have an added factor of "intent" that contractors have tried to apply.<sup>136</sup>

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<sup>133</sup> See e.g., *American Elec.*, ASBCA No. 16,635, ¶ 12,151.

<sup>134</sup> *Id.*

<sup>135</sup> *Id.* at 21,801.

<sup>136</sup> In the recent major termination, mentioned *supra* at note 118, the intent argument resurfaced when the contractor argued that the Government should consider its entire plant SME because the Government concurred in its construction. The facts did not support their allegation that the Government discussed and approved the construction of the plant, so the TCO disallowed most of the facility's costs.

### 3. Hypothetical Analysis

So how does a contracts attorney analyze the allowability of the cost of an overhead rail system designed to transport the contract items throughout the plant? First, the contracting officer could argue that it is not special machinery and equipment. The system as purchased was an off-the-shelf modular system that bolted together before being installed in the ceiling of the plant. As such, it did not appear to be “special machinery and equipment” as the cases describe the term; it was not an item peculiar to one contract that the contractor could not remove and reuse on the contractor’s other work.

Assuming it is special machinery, the next issue is title. Did the contractor offer title to the Government? Here, the contractor did not offer title, which militates against finding the special machinery allowable.

Next, did the contractor appropriately apportion the loss of useful value amount sought to the proportionate amount the equipment was used for the terminated contract? Here, the contractor only used the equipment on the terminated contract, so apportionment to the other work of the contractor was not an issue.

Finally, in accordance with *American Electric*, what was the intent of the parties regarding this equipment? Did they agree that this equipment was going to be necessary to perform the contract? Unlike the situation in *American Electric*, the Government here did not agree with the contractor’s election to create this custom item transport system. In fact, the Government did all it could at contract inception to try to get the contractor to use existing facilities and capabilities to perform the contract, rather than purchasing a lot of expensive equipment. Based on the foregoing, a BCA would likely disallow this termination settlement claim for “special machinery and equipment.”

#### **E. 31.205-42(e): Rental Costs under Unexpired Leases**

Rental costs<sup>137</sup> under unexpired leases is one provision of termination costs that is seldom challenged.<sup>138</sup> In dealing with these costs, the CAM

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<sup>137</sup> FAR, *supra* note 2, at 31.205-42(e) states:

Rental costs under unexpired leases, less the residual value of such leases, are generally allowable when shown to have been reasonably necessary for the performance of the terminated contract, if-

- (1) The amount of rental claimed does not exceed the reasonable use value of the property leased for the period of the contract and such further period as may be reasonable and;
- (2) The contractor makes all reasonable efforts to terminate, assign, settle, or otherwise reduce the cost of such lease.

recommends looking at the length of the lease in relation to the anticipated contract period and whether the lease expense is comparable to the expenses at other facilities in the area. It notes that where a leased facility supports several contracts, the portion allocable to the terminated contract will be allowable if the facility was leased in order to perform the now-terminated contract. If the terminated contract was performed in a facility already leased for other contracts, the lease cost will not be allowable.<sup>139</sup>

The contract appeals involving disallowance of rental costs under unexpired leases mostly revolve around whether the lease expense was for a reasonable period of time after the termination and whether the contractor made efforts to sublet or otherwise mitigate the lease expense. For instance, in *Southland Manufacturing Corp.*,<sup>140</sup> the contractor was allowed to recover lease costs and incentive rental credits from the wrongful default termination in December 1964 through May 1967 because it had made efforts to sublease the premises and was unable to execute a lease for the property.<sup>141</sup>

It is unclear whether the absolute limit of rental costs under unexpired leases is necessarily the contract completion date. The United States Court of Claims (now the COFC) has held that the allowable period may extend past the contract completion date if it is reasonable.<sup>142</sup> However, the DOTBCA has more recently held that lease costs for two months past the termination date were unallowable where the contractor had been unreasonable in executing a lease that extended two years beyond the contract performance date.<sup>143</sup> Further, in *Quallex*,<sup>144</sup> the ASBCA split the ruling on rental costs of unexpired leases. On one hand it supported disallowing reimbursement for unexpired lease costs past the termination because the contractor bore the risk of the Government not continuing the contract past the initial performance period. On the other, it allowed reimbursement for the long-lease discount on lease costs that inured to the Government's benefit as a result of the contractor's five-year lease.<sup>145</sup>

All that is clear from the few cases on this issue is that “. . . a reasonable period of time is a question of fact and is based upon the reasonable

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<sup>138</sup> This may be because Government contractors negotiate favorable leases including termination for convenience clauses, or more likely because TCO's allow reasonable lease expenses past the termination in order to give contractors an opportunity to wind-up operations and remove equipment. The phrase “reasonable use value of the property leased for the period of the contract and such further period as may be reasonable” gives the TCO broad latitude to allow post-termination lease costs.

<sup>139</sup> CAM, *supra* note 55, at 12-305.5.

<sup>140</sup> *Southland*, ASBCA No. 16,830, ¶ 10,994.

<sup>141</sup> *Id.* at 52,362.

<sup>142</sup> *Sundstrand Turbo v. U.S.*, 389 F.2d 406, 415 (Ct.Cl., 1968).

<sup>143</sup> *TDC Mgmt.*, DOTBCA No. 1802, ¶ 24,091 at 120,574.

<sup>144</sup> *Quallex Int'l*, ASBCA No. 41,962, ¶ 25,517 at 127,090.

<sup>145</sup> *Id.* at 127,088-9.



efforts of the contractor to reduce the lease costs.”<sup>146</sup> Lest one think that lease costs only apply to real property or facilities leases, that is not the case. Rental costs for unexpired leases have been allowed for computer hardware<sup>147</sup> and have been argued to apply to chartered tugboats.<sup>148</sup>

### *Hypothetical Analysis*

What about the cost of the remaining fourteen months of MI’s lease on the building in which it is located? If the lease extends only out to the projected contract completion date and the contractor cannot get out of the lease, despite its best efforts, then the lease costs are likely allowable. If the contract was scheduled to be completed twelve months after the termination date, then under *TDC Management Corporation* and *Qualex*, a contracts attorney should argue for the contracting officer to disallow the costs because the contractor should not have counted on continuing work from the Government. The only further question, under *Qualex*, is whether the contractor would be entitled to recover the amount of any long-lease discounts that might have inured to the Government’s benefit.

### **F. 31.205-42(f): Alterations of Leased Property<sup>149</sup>**

This section was new to the FAR when it was published in 1983.<sup>150</sup> This subsection permits recovery on termination of costs incurred by a contractor to prepare, improve or alter leased facilities used for the performance of a terminated contract. The CAM deals with alterations to leased property in subparagraph 12-305.5, Rental Costs Under Unexpired Leases.<sup>151</sup> Subparagraph 12-305.5(b) says that cost of leased property alterations is allowable and directs auditors to “[a]djust unexpired lease costs

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<sup>146</sup> CIBINIC & NASH, *supra* note 1, at 1113 (summarizing *Southland*, ASBCA No. 16,830, ¶ 10,994.

<sup>147</sup> General Elec. Co., ASBCA No. 24,111, 1982 WL 7083, 82-1 B.C.A. (CCH) ¶ 15,725 (1982) (stating computer hardware rental costs continuing after termination were allowable where cancellation would have entailed substantial additional charges).

<sup>148</sup> Bos’n Towing and Salvage Co., ASBCA No. 41,357, 1992 WL 40,703, 92-2 B.C.A. (CCH) ¶ 24,864 (Feb. 27, 1992)(holding that whether FAR 31.205-42(e) or subcontract rules applied to rental costs of chartered tugboat, the principle of reasonableness in either is guiding principle in settlements).

<sup>149</sup> FAR, *supra* note 2, at 31.205-42(f): “Alterations of leased property. The cost of alterations and reasonable restoration required by the lease may be allowed when the alterations were necessary for performing the contract.”

<sup>150</sup> Before being FAR 31.205-42(f), it was Defense Acquisition Regulation 15.205-42(E)(II) and before that it was Armed Services Procurement Regulation 15-205.42(E)(II). The language, however, has not changed substantially from one regulation to the next.

<sup>151</sup> CAM, *supra* note 55, at 12-305.5(b).

by any residual value of the lease due to termination, assignment or settlement of the lease agreement.”<sup>152</sup>

There is very little case law on this issue. The only cases clearly addressing this issue are *Southland Manufacturing Corporation*,<sup>153</sup> and *Energy Compression Research Corporation*.<sup>154</sup> In *Southland*, the contractor claimed the depreciated value of leasehold improvements that consisted of landscaping, partitions and electrical work. The ASBCA held that recovery under Armed Services Procurement Regulation (ASPR) 15-205.42(e) was not allowable; however, the ASBCA did ultimately allow recovery because the amount claimed was reasonable, allocable and within general accounting principles and practices appropriate to the circumstances.<sup>155</sup> In *Energy Compression*, the contractor claimed the costs of improving property that they had leased. The ASBCA held, however, that since they had leased the property in anticipation of a Government contract and not as a result of a Government contract, the leasehold improvements were not allowable.<sup>156</sup>

### *Hypothetical Analysis*

Based upon the rule and the above cases, it appears that the cost of relocating floor anchors for the 5-axis machine tool would be allowable because it was an improvement to the leased facilities that was required for performance of the contract. However, if the work had been done in anticipation of a government contract, the costs may not be allowable.

### **G. 31.205-42(g): Settlement Expenses**

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<sup>152</sup> *Id.* at 12-305.5(b).

<sup>153</sup> *Southland*, ASBCA No. 16,830, ¶ 10,994.

<sup>154</sup> *Energy Compression Research Corporation*, ASBCA No. 46,560, 1999 WL 727949, 99-2 B.C.A. (CCH) ¶ 30,564 (A.S.B.C.A., 1999).

<sup>155</sup> *Southland*, ASBCA No. 16,830, ¶ 10,994 at 52359.

<sup>156</sup> *Energy Compression*, ASBCA No. 46,560, ¶ 30,564 at 150,944.

Settlement expenses<sup>157</sup> are those expenses associated with the labor costs and material costs that arise from personnel working on the contract termination settlement effort (as opposed to the personnel completing the last few uncompleted items the contractor may have been directed to complete). Direct costs for personnel employed by the terminated contractor (such as the property managers, accountants, and clerical staff) and personnel hired as outside consultants (attorneys, accountants, evaluators) are generally allowable.<sup>158</sup> Indirect costs such as payroll taxes, fringe benefits, occupancy costs, and immediate supervision costs are also allowable.<sup>159</sup>

In auditing settlement expenses, DCAA looks at whether the contractor established a separate accounting code for work performed on the termination settlement.<sup>160</sup> An auditor will look for the costs of direct labor and materials expended and an amount for related overhead costs.<sup>161</sup> Much of the auditor's guidance requires him or her to second-guess the contractor and apply common sense. The auditor must determine whether:

- The work done corresponds to the pay level of the employee doing the work;<sup>162</sup>
- The amount of time spent corresponds to the time required for the termination activities;<sup>163</sup>
- The cost of professional accounting services is reasonable;<sup>164</sup>
- The cost of legal expenses is reasonable;<sup>165</sup> and
- The cost of storage charged is reasonable.<sup>166</sup>

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<sup>157</sup> FAR 31.205-42(g) defines settlement expenses as:

- (1) Settlement expenses, including the following, are generally allowable:
  - (i) Accounting, legal, clerical, and similar costs reasonably necessary for-
    - (A) The preparation and presentation, including supporting data, of settlement claims to the contracting officer; and
    - (B) the termination and settlement of subcontracts.
  - (ii) Reasonable costs for the storage, transportation, protection, and disposition of property acquired or produced for the contract.
  - (iii) Indirect costs related to salary and wages incurred as settlement expenses in (i) and (ii); normally, such indirect costs shall be limited to payroll taxes, fringe benefits, occupancy costs, and immediate supervision costs.
- (2) If settlement expenses are significant, a cost accountant or work order shall be established to separately identify and accumulate them.

FAR, *supra* note 2, at 31.205-42(g).

<sup>158</sup> *Id.* at 31.205-6. *See also* CAM, *supra* note 55, at 12.309(a)-(b).

<sup>159</sup> *Id.*

<sup>160</sup> CAM, *supra* note 55, at 12.309(a).

<sup>161</sup> *Id.* at 12.309(b).

<sup>162</sup> *Id.* at 12.309(c).

<sup>163</sup> *Id.* at 12.309(f).

<sup>164</sup> *Id.* at 12.309(i).

<sup>165</sup> *Id.* at 12.309(j).

<sup>166</sup> *Id.* at 12.309(k).

The CAM also advises that when a settlement proposal becomes a Contract Disputes Act claim, the legal and consultants' costs incurred in the prosecution of the claim are unallowable.<sup>167</sup> The case law indicates a number of recurring issues that arise when considering 31.205(g) settlement expenses. These issues can be grouped into two categories: legal fees and salaried employees.

### 1. Legal Fees

As noted above, the DCAA looks for proper documentation of personnel working, hours worked and some idea of what the personnel did. If a contractor makes a claim for legal fees, but there is insufficient documentation of the exact or the approximate amount of time devoted to the termination settlement claim, legal fees will not be allowable.<sup>168</sup> When legal fees claimed are for work on a claim against the Government, the legal fees are also not allowable.<sup>169</sup> Claims for legal and accounting fees incurred in termination settlement efforts are generally allowable, but to the extent they were expended in preparation of claims that are not compensable, such as claims for anticipatory profits, they are unallowable.<sup>170</sup> Finally, attorneys fees are not allowable when they are based upon a contingency fee arrangement.<sup>171</sup>

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<sup>167</sup> *Id.* at 12.309(m). The distinction between a proposal and a claim is defined as follows:

A termination proposal submitted under a termination clause is not a claim because it is submitted for the purpose of negotiation. However, a termination proposal becomes a claim under the Contract Disputes Act (CDA) upon the occurrence of one of three events: (1) the contractor's submission indicates that the contractor desires a final decision and the contracting officer does not accept its proposed terms, (2) negotiations between the TCO and the contractor are at an impasse, thus implicitly requiring the TCO to issue a final decision, or (3) the TCO issues a final decision.

*Id.* at 12.101(i).

<sup>168</sup> *Nolan Bros. v. United States*, 437 F.2d 1371, 1390-91 (Ct.Cl., 1971).

<sup>169</sup> *Metered Laundry*, ASBCA No. 21,573, ¶13,206 at 64,606 (allowing legal fees for work on ASBCA appeal); *Information Systems and Networks Corp.*, ASBCA No. 42,659, 1999 WL 1049634, 00-1 B.C.A. (CCH) ¶ 30,665 (Nov. 18, 1999); *Qualex Int'l*, ASBCA No. 41,962, ¶ 25,517 at 127,090 (holding legal fees for participating in ADR is participating in prosecution of claim against the Government). *But see Bos'n Towing and Salvage*, ASBCA No. 41,357, ¶ 24,864 at 124,034 (holding GAO and SBA proceedings brought by contractor were not within the FAR 31.205-33(d) definition of "claims or appeals" against the Government, so legal fees allowable).

<sup>170</sup> *Dairy Sales, Corp.*, 593 F.2d (\$4100 claim for legal and accounting fees reduced to \$900 because bulk of fees spent pursuing anticipatory profits).

<sup>171</sup> *Hugo Auchter*, ASBCA No. 39,642, ¶ 23,645 at 118,444 (holding that evidence established that attorney would be paid the claimed fee only after appellant has been paid by the Government and appellant introduced no evidence of hours billed under other type of arrangement). *But see Fiesta Leasing and Sales, Inc.*, ASBCA No. 29,311, ¶ 19,622 at 99,294 (allowing legal fees where Government alleged but did not prove a contingency fee arrangement).

However, in a situation where legal fees appear both standard and contingent, if the parties agreed to an hourly and daily charge that is reasonable in amount and not contingent upon reimbursement by the Government, then the legal fees will be allowable.<sup>172</sup>

## 2. Salaried Employees

The boards and courts generally do not question the rates paid by a contractor for personnel that work on a termination settlement, including regular contractor personnel. However, they do question additional amounts paid to salaried employees. In particular, there must be a showing by the contractor that a salaried employee's work on a termination was over and above the work the employee did for his salary.<sup>173</sup> Perhaps by virtue of their positions of authority, company presidents' rates of compensation seem to get very careful scrutiny by the boards.<sup>174</sup>

In addition to the above, recently the boards and courts have journeyed into new areas of settlement expenses. In *McDonnell Douglas Corp. v. United States*<sup>175</sup> the COFC looked at whether retention bonuses could be recovered under FAR 31.205-42(g) and agreed with the contractor that such bonuses benefited both the contractor and the Government and the Government should pay them. In *Energy Compression*,<sup>176</sup> the Board sustained denial of a claim for a consultant whose services consisted of managing the work of the attorneys in the settlement of the vendor's claims.

## 3. Hypothetical Analysis

So what about the attorney's fees for the preparation of the original bid and the contractor's settlement proposal? Assuming that the fees are not on a contingency fee basis and the contractor has properly documented the time spent and work done, they will likely be allowable. If the contractor claims fees for any work done on the contract appeal then those fees will not be allowable.

### H. 31.205-42(h) Subcontractor Claims

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<sup>172</sup> *Southland*, ASBCA No. 16,830, ¶ 10,994 at 52,365.

<sup>173</sup> *Fiesta Leasing and Sales, Inc.*, ASBCA No. 29,311, ¶ 19,622 at 99,294 (stating salaried employee's compensation should be through overhead rates in absence of evidence that another employee was hired to cover his other work or he recorded overtime on the termination).

<sup>174</sup> *Hugo Aughter*, ASBCA No. 39,642, ¶ 23,645 at 118,444 (holding company president Aughter's DM 200/hr termination settlement rate should have been his DM 92/hr salary rate); *Tubergen*, ASBCA Nos. 34,106, 34,107, ¶ 23,058 at 115,766-7 (holding Mr. Tubergen's claimed 150 hours was excessive and reducing it to 50 hours).

<sup>175</sup> *McDonnell Douglas*, 40 Fed.Cl. at 554.

<sup>176</sup> *Energy Compression*, ASBCA No. 46,560, ¶ 30,564 at 150,945.

Far provision 31.205-42(h), Subcontractor Claims,<sup>177</sup> makes allowable virtually all of the termination costs a subcontractor bills to a contractor.<sup>178</sup> The key element to the allowability of subcontractor settlements is that throughout the process the Government seeks to maintain privity with the contractor and avoid privity with the subcontractors. Thus, the FAR intends the subcontract settlement process to permit the contractor to reach settlement with its subcontractors and then submit a claim for reimbursement of the settlement amounts it paid the subcontractors. Only in rare situations can the Government negotiate settlement directly with subcontractors,<sup>179</sup> and even then, “[d]irect settlements with subcontractors are not encouraged.”<sup>180</sup>

The CAM advises that subcontractor settlements generally follow the principles of prime contract settlements. The subcontractor’s rights are against the prime, not against the Government.<sup>181</sup> Auditors are told to look specifically at settlements that were made without contracting officer approval or ratification using the authority granted under FAR 49.108-4.<sup>182</sup>

The boards and courts review allowability of subcontract settlements for reasonableness and prudence.<sup>183</sup> This means the board or court will look for the settlement to be a result of “arm’s length” bargaining between the contractor and the subcontractor.<sup>184</sup> If the settlement appears to be the result of collusion, then the ASBCA will disallow all or a portion of the settlement.<sup>185</sup> Once the contractor and subcontractor reach a settlement, the amounts claimed

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<sup>177</sup> FAR, *supra* note 2, at 31.205-42(h):

Subcontractor claims. Subcontractor claims, including the allocable portion of the claims common to the contract and to other work of the contractor, are generally allowable. An appropriate share of the contractor’s indirect expense may be allocated to the amount of settlements with subcontractors; provided, that the amount allocated is reasonably proportionate to the relative benefits received and is otherwise consistent with 31.201-4 and 31.203(c). The indirect expense so allocated shall exclude the same and similar costs claimed directly or indirectly as settlement expenses.

<sup>178</sup> This primer will not go into the rules for submission of subcontractor settlements, as they are listed at FAR , *supra* note 2, at 49.108.

<sup>179</sup> FAR, *supra* note 2, at 49.108-7 (discussing government assistance in settling subcontracts).

<sup>180</sup> *Id.* at 49.108-8, (discussing assignment of rights under subcontracts).

<sup>181</sup> CAM, *supra* note 55, at 12-310(a).

<sup>182</sup> *Id.* at 12-310(b).

<sup>183</sup> *Bos’n Towing and Salvage*, ASBCA No. 41,357, ¶ 24,864 at 124,031.

<sup>184</sup> *General Electric*, ASBCA No. 24,111, ¶ 15,725 at 77,806 (stating termination settlement with subcontractor arrived at after arm’s length bargaining without collusion and reflected sound exercise of business judgment).

<sup>185</sup> *Bos’n Towing and Salvage*, ASBCA No. 41,357, ¶ 24,864 at 124,032 (finding subcontractor was not truly independent from prime and disallowed substantial portion of termination settlement relating to tugboat improvements.); *See also, Joint Venture G.C.D.*, ASBCA No. 47,285, ¶ 28,976 at 144,310 (holding contractor’s “Private Contract Agreement” amongst joint venture partners to reimburse for unperformed work not one that a prudent businessman would enter into, so settlement disallowed.)

are generally allowable.<sup>186</sup> As the COFC has recently stated, “[w]here sufficient evidence of allowability, allocability and reasonableness of costs are found, however, the court must sustain those [subcontractor] costs as incurred.”<sup>187</sup>

### *Hypothetical Analysis*

Is the cost of terminating MI’s electronics subcontractor for convenience allowable? Assuming the parties arrived at a subcontract settlement through arm’s length bargaining, the costs will be allowable. If, for instance, the electronics subcontractor is a wholly owned subsidiary of MI and several of the MI board are on the subcontractor’s board, then there may be cause for the auditor and the TCO to question the settlement costs after a careful review of the settlement documents.

## **IV. CONCLUSION**

As mentioned above, this primer helps to enlighten the average contracts attorney about what goes on in a convenience termination, who the players are, and where to find answers to the questions that typically arise. The primer also gives the contracts attorney a feel for how to analyze one of the most confusing areas that can come up in a termination settlement negotiation: the allowability of termination costs under FAR 31.205-42. Thus informed, it is up to the contracts attorney to work with the TCO and the DCAA Auditor to arrive at the right decision on the termination costs.

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<sup>186</sup> CIBINIC & NASH, *supra* note 1, at 1116 (citing McDonnell Douglas Corp., 1968 WL 867, NASABCA 467-13, 68-2 B.C.A. (CCH) ¶ 7,316 (Oct. 7, 1968)).

<sup>187</sup> *McDonnell Douglas*, 40 Fed.Cl. at 536-542 (Numerous subcontractor settlement claims made before and after Government convenience termination found allowable.).

# “SPACE FORCE ALPHA”

## MILITARY USE OF THE INTERNATIONAL SPACE STATION AND THE CONCEPT OF “PEACEFUL PURPOSES”

MAJOR CHRISTOPHER M. PETRAS \*

*Man has certain qualitative capabilities which machines cannot duplicate. He is unique in his ability to make on the spot judgments.... Thus by including man in military space systems, we significantly increase the flexibility of the systems, as well as increase the probability of mission success.<sup>1</sup>*

### I. INTRODUCTION

For the first twenty-five years of the “Space Age” (1957-1982), outer space activities were almost exclusively performed by governments, acting individually or in concert through intergovernmental agencies,<sup>2</sup> and, while the potential military utility of space systems intended for civil or commercial uses

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<sup>1</sup> Congressional testimony of General James Ferguson (USAF), the Deputy Chief of Staff for Research and Development, regarding the Air Force’s ten-year space plan, issued in September 1961, which included a manned military capability in space. *Quoted in* R.F. FUTRELL, IDEAS, CONCEPTS, DOCTRINE: A HISTORY OF BASIC THINKING IN THE UNITED STATES AIR FORCE 1907-1964, at 431 (Air Univ. Press 1971).

<sup>2</sup> See Lawrence D. Roberts, *A Lost Connection: Geostationary Satellite Networks and the International Telecommunication Union*, 15 BERKELEY TECH. L.J. 1095, 1096-1097 (2000) (“For most of its history, space activity has been the province of government.... While the potential for commercial activity involving outer space was recognized relatively early on, and there were occasionally dramatic successes, commercial investments represented only a tiny portion of total space expenditures.” (footnotes omitted)); see also Christian Roisse, *The Roles of International Organizations in Privatization and Commercial Use of Outer Space*, Discussion Paper presented at the Third U.N. Conf. on the Exploration and Peaceful Uses of Outer Space (1999) (copy on file with author) (“In the early nineteen sixties, any utilization and, above all, any commercial use of Outer Space was not conceivable with the involvement of entities other than intergovernmental agencies.”); and Henry Wong, *2001: A Space Legislation Odyssey—A Proposed Model for Reforming the Intergovernmental Satellite Organizations*, 48 AM. U. L. REV. 547, 548-556 (1998) (on the factual and legal history of international satellite organizations).



did not go unnoticed,<sup>3</sup> “the development and use of space technology for military and civil applications... [generally] occurred in parallel” through separate military and civilian agencies.<sup>4</sup> Such was the case in the early 1960s, when the U.S. Air Force undertook development of a military space station—called the Manned Orbiting Laboratory (MOL)—on the basis that the then ongoing National Aeronautic and Space Administration (NASA) “Gemini” project did not provide necessary data on potential military capabilities in space.<sup>5</sup> By the end of the decade, however, the high cost of the continuing war in Vietnam, the onset of détente with the Soviets, and the recognition that the main military objectives of the MOL (*i.e.*, reconnaissance and satellite detection and inspection) could be performed by less costly unmanned satellite systems, spelled the end of the project.<sup>6</sup> And so, with the cancellation of the Air Force’s MOL in June 1969, manned spaceflight in the United States became the exclusive province of NASA.<sup>7</sup>

After cancellation of the MOL program, the concept of a military space station garnered remarkably little enthusiasm among American military leaders.<sup>8</sup> A number of factors contributed to this lack of interest, including budgetary considerations, the government’s “desire to minimize the visibility and notoriety of [its] military presence in space,” and, perhaps most importantly, the lack of any “compelling arguments that having crews in orbit gives a State any particular useful military or strategic advantage.”<sup>9</sup> Yet, in a

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<sup>3</sup> See *e.g.*, STAFF OF HOUSE COMM. ON GOVERNMENT OPERATIONS, 89TH CONG., REPORT ON GOVERNMENT OPERATIONS IN SPACE (ANALYSIS OF CIVIL-MILITARY ROLES AND RELATIONSHIPS), at 31 (Comm. Print 1965) (“[P]ractically every peaceful use of outer space appears to have a military application.”).

<sup>4</sup> See STEPHEN E. DOYLE, CIVIL SPACE SYSTEMS: IMPLICATIONS FOR INTERNATIONAL SECURITY 2 (U.N. Inst. for Disarmament Research 1994).

<sup>5</sup> The U.S. Air Force conducted a series of experiments that essentially supplemented and were closely coordinated with NASA’s Gemini program. In fact, such experiments on board Gemini V (August 1965) drew protest from the Soviet Union over their military nature. The MOL was actually based on a modified Gemini capsule. See DAVID N. SPIRES, BEYOND HORIZONS: A HALF CENTURY OF AIR FORCE SPACE LEADERSHIP, at 120-133 (rev. ed., Air Univ. Press 1998); and PAUL B. STARES, THE MILITARIZATION OF SPACE: U.S. POLICY, 1945-1984, at 79, 97-99, 130-131 (Cornell Univ. Press 1988); see generally BARTON C. HACKER & JAMES M. GRIMWOOD, ON THE SHOULDERS OF TITANS: A HISTORY OF PROJECT GEMINI 259 (NASA Special Publication No. 4203, 1977), available at <http://www.hq.nasa.gov/office/pao/History/SP-4203/toc.htm> (discussing the nature of the military experiments conducted aboard Gemini V); and S. HOUSTON LAY & HOWARD J. TAUBENFELD, STUDY ON THE LAW RELATING TO ACTIVITIES OF MAN IN SPACE, at 26 n.101 (1970) (discussing photographs taken from Gemini V and Soviet objections to the mission as a “spy flight”).

<sup>6</sup> See SPIRES, *supra* note 5, at 132-33; and STARES, *supra* note 5, at 159-60.

<sup>7</sup> The data and equipment from the MOL project were transferred to NASA for use in what became the NASA Skylab space station operation. SPIRES, *supra* note 5, at 133.

<sup>8</sup> DOYLE, *supra* note 4, at 77.

<sup>9</sup> *Id.* at 76-77; see also STARES, *supra* note 5, at 242 (“With the cancellation of... [the] MOL, many in the Air Force believed that they had made their pitch and failed. This in turn reduced

1983 Department of Defense (DoD) study on the relation of military space activities to space stations, which concluded that there were “no identifiable mission requirements that could be uniquely satisfied by a manned space station” and “no current requirements... [for which] a manned space station would appear to provide a significant improvement to DoD over alternative methods of performing a given task,” the Department nonetheless recognized the possibility that the situation could change over time and, accordingly, espoused its commitment “to developing a better understanding of the potential future uses for the role of man in space.”<sup>10</sup> In fact, the concept of “Military Personnel-in-Space” remains, to this day, a part of official DoD policy:

Military Personnel-in-Space. The unique capabilities that can be derived from the presence of humans in space may be utilized to the extent feasible and practical to perform in-space research, development, testing, and evaluation as well as enhance existing and future national security space missions. This may include exploration of military roles for humans in space focusing on unique or cost-effective contributions to operational missions.<sup>11</sup>

Thus, the “coolness” of the U.S. military toward the notion of stationing personnel in space notwithstanding, manned spaceflight continues to have significant military implications, if for no other reason than “the capacity to place personnel in orbit... allows for the active management by the crew on orbit of various technological capabilities that can be used for military applications.”<sup>12</sup> Furthermore, a State does not have to launch a *military* crew into Earth orbit in order to obtain militarily useful information from a crewed mission.<sup>13</sup> For example, in the case of photoreconnaissance:

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the incentives to try again and reinforced the bias towards the traditional mission of the Air Force, namely flying.”).

<sup>10</sup> Eilene Galloway, *The Relevance of General Multilateral Space Conventions to Space Stations*, in *SPACE STATIONS: LEGAL ASPECTS OF SCIENTIFIC AND COMMERCIAL USE IN A FRAMEWORK OF TRANSATLANTIC COOPERATION*, 5 *STUDIES IN AIR AND SPACE LAW* 33, 36 (Karl-Heiz Böckstiegal ed. 1985) (Proceedings of an International Colloquium held in Hamburg, Oct. 3-4, 1984) (quoting *Military Activities and a Space Station*, in *SPACE STATION: POLICY, PLANNING AND UTILIZATION* (Proceedings of the AIAA/NASA Symposium on the Space Station at Arlington, Virginia, Jul. 18-20, 1983)) [hereinafter *SPACE STATIONS*].

<sup>11</sup> DoD Directive 3100.10, Space Policy, para. 4.11, at 13 (Jul. 9, 1999) [hereinafter *DoDD 3100.10*]; cf. Department of Defense Space Policy, Unclassified, at 2 (Mar. 10, 1987), available at <http://sun00781.dn.net/spp/military/docops/defense/87memo.htm> [hereinafter *DoD Space Policy (1987)*] (“DoD supports the potential use of military man-in-space. DoD will ensure that the unique capabilities that can be derived from the presence of military man-in-space shall be utilized to the extent feasible to perform in-space research and development, and to enhance existing and future missions in the interest of national security. DoD will actively explore roles for military man-in-space focusing on unique or cost-effective contributions to operational missions.”). The official version of the policy was signed by Secretary of Defense Weinberger on Feb. 4, 1987, and remains classified.

<sup>12</sup> DOYLE, *supra* note 4, at 78-79.

<sup>13</sup> *Id.* at 79.

[d]epending upon the sensing or photographic equipment onboard a space mission, even a civil crew... could obtain and deliver highly valuable military information... [and,] [w]ithout access to flight telemetry and flight data products it would be impossible to know to what extent the crewed mission was or was not involved in information gathering of a military nature or of military value.<sup>14</sup>

What's more, recent developments vis-à-vis the multi-billion dollar partnership of the United States, Russia, Europe, Japan and Canada, otherwise known as the International Space Station (ISS) (designated "Alpha"), have also given the notion of the "military man-in-space" renewed relevance in the context of current international law. Specifically, in March 2001, Russia's *Mir* space station circled the earth for the last time and, after a controlled decent, plunged into the Pacific Ocean. As a result, the ISS is now the only space station currently occupying outer space, and is therefore one of only two operational space platforms available for evaluating the military capabilities that can be derived from a human presence in space and performing in-space research, development, testing, and evaluation in support of national security<sup>15</sup>—the other being the Space Shuttle.<sup>16</sup>

Meanwhile, the newly appointed NASA administrator<sup>17</sup> has called for closer ties between his agency and DoD.<sup>18</sup> Additionally, the United States and its partners are currently formulating plans for commercialization of the ISS,<sup>19</sup> and insofar as these plans allow nonmilitary crews to perform ostensibly "commercial" activities with direct military applications for or on-behalf of national defense industries, there will inevitably be activities of a military nature or of military value taking place onboard the Space Station in the near future.

The prospect of military use of the ISS undoubtedly raises questions about the permissibility of military activities within the confines of the 1998 Intergovernmental Agreement (1998 IGA) that established the ISS

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<sup>14</sup> *Id.*

<sup>15</sup> See DoDD 3100.10, *supra* note 11, para. 4.11, at 13.

<sup>16</sup> See generally Walter D. Reed & Robert W. Norris, *Military Use of the Space Shuttle*, 13 AKRON L. REV. 665, 683-85 (1979).

<sup>17</sup> Mr. Sean O'Keefe was nominated by President George W. Bush and subsequently sworn in as Administrator of NASA on December 21, 2001.

<sup>18</sup> Seth Hettena, *Military Uses Images in Combat*, ASSOCIATED PRESS, Apr. 11, 2002, available at <http://wire.ap.org/ Apnews/?SITE=MNMIT&FRONTID=HOME>.

<sup>19</sup> See Commercialization of the Space Station, 42 U.S.C. § 14711 (2001) ("[A] priority goal of constructing the International Space Station is the economic development of Earth orbital space... [to include] the fullest possible engagement of commercial providers and participation of commercial users."); see also John M. Logsdon, *Commercializing the International Space Station: Current US Thinking*, 14 SPACE POLICY 239 (1998) ("[C]ommercial utilization of the space station is a key element of [NASA's] overall commercialization strategy; see generally Peter B. de Selding, *ISS Partners Set Boundaries: Governments Try to Limit Competition for Commercialization*, SPACE NEWS, Jun. 11, 2001, at 1, 35.

partnership;<sup>20</sup> moreover, it rekindles an old debate about the lawfulness of military activities in outer space under international law generally. This latter dispute centers on the scope and applicability of the 1967 Outer Space Treaty, and, specifically, the meaning of the language in Article IV relating to the use of space for “peaceful purposes,”<sup>21</sup> with some arguing that peaceful purposes should be understood to be “nonmilitary,” and others, including the United States, interpreting it as meaning “nonaggressive.”<sup>22</sup> Thus, the extent to which military-related activities may be lawfully carried out onboard the ISS has significant implications for the fifteen Partner States that are party to the 1998 IGA (the United States, Russia, Canada, Japan, and the eleven member states of the ESA<sup>23</sup>), as well as for other spacefaring States and international community as a whole.

The purpose of this article is to examine the permissibility of military activity (including commercial activities with military ends) onboard the ISS. The article is divided into four parts: Part I looks at the 1998 IGA framework and discusses significant provisions of the Agreement and implementing documents; Part II provides a brief overview of the body of public international law governing outer space, the “*corpus juris spatialis*”; Part III analyzes the issue of the military use of the ISS, focusing primarily on the meaning of the term “peaceful purposes” as it applies to outer space and its relevance to ISS activities, while also considering other legal and contextual issues, such as the significance of the characterization of the ISS as a “civil” facility; and, finally, Part IV provides some concluding comments. In the end, the piece makes clear that, although “peaceful purposes” as generally applied to outer space has taken on a meaning which allows for some extraterrestrial military activities, the ISS Partners are divided on what the phrase means with respect to utilization of Alpha. Moreover, the piece shows that because of the ambiguity of the 1998 IGA with respect to the ability of any given Partner to restrict military use of the ISS by its counterparts, the meaning of “peaceful purposes” is a potential source of future discord, especially as

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<sup>20</sup> Agreement among the governments of Canada, Member States of the European Space Agency, Japan, the Russian Federation, and the United States of America concerning Cooperation on the Civil International Space Station, Jan. 29, 1998, 1998 U.S.T. LEXIS 212, Hein’s No. KAV 5119 [hereinafter 1998 IGA], reprinted in 4 UNITED STATES SPACE LAW: NATIONAL & INTERNATIONAL REGULATION, § II.A.22(f) (May 1998) [hereinafter U.S. SPACE LAW].

<sup>21</sup> Treaty on Principles Governing the Activities of States in the Exploration and Use of Outer Space, Including the Moon and Other Celestial Bodies, Jan. 27, 1967, art. IV, U.N. GAOR, 21st Sess., Supp. No. 16, at 13, U.N. Doc. A/6316 (1967); 18 U.S.T. 2410; 1967 U.S.T. LEXIS 613 [hereinafter Outer Space Treaty].

<sup>22</sup> Michael N. Schmitt, *Bellum Americanum: The U.S. View of Twenty-First Century War and Its Possible Implications for the Law of Armed Conflict*, 19 MICH. J. INT’L L. 1051, 1087 (1998).

<sup>23</sup> Belgium, Denmark, France, Germany, Italy, the Netherlands, Norway, Sweden, Switzerland, Spain and the United Kingdom.

commercialization opens up the facility for uses by private industry that could have military significance.

## II. THE INTERGOVERNMENTAL AGREEMENT OF 1998

The development and construction of an International Space Station (ISS) began in the mid-1980s, with the U.S. plan to place a permanently inhabited civil space station (known as “Space Station Freedom”) into low-earth orbit through a partnership with Canada, Japan, and a number of European countries.<sup>24</sup> This “Space Station Freedom” initiative eventually culminated in the establishment of the 1988 Intergovernmental Agreement (1988 IGA)<sup>25</sup> among the United States, the state partners of the European Space Agency (ESA),<sup>26</sup> Japan and Canada. Under the 1988 IGA, the United States (NASA) would produce a “core U.S. Space Station,” which would then be enhanced with elements produced by the ESA, the Government of Japan (GoJ), and Canada Space Agency (CSA), to create an “international Space Station complex.”<sup>27</sup> In addition to emphasizing the “civil” character of the space station, the 1988 IGA also specified that the station be used “*for peaceful*

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<sup>24</sup> See Rochus Moenter, *The International Space Station Legal Framework and Current Status*, 64 J. AIR L. & COM 1033 (1999); see also Act of Oct. 30, 1987, Pub. L. No. 100-147, § 106(a) and (e), 101 Stat. 863 (1987) [hereinafter Act of Oct. 30, 1987].

<sup>25</sup> Agreement among the governments of the United States of America, the Member States of the European Space Agency, Japan, and Canada, on Cooperation in the Detailed Design, Development, Operation, and Utilization of the Permanently Manned Civil Space Station, Sept. 29, 1988, as between the U.S., the ESA partner states, and Canada, Hein’s No. KAV 2383, with respect to Japan, Hein’s No. KAV 2382 [hereinafter 1988 IGA], reprinted in 4 UNITED STATES SPACE LAW: NATIONAL & INTERNATIONAL REGULATION, § II.A.22 (Jan. 1989) [hereinafter U.S. SPACE LAW].

<sup>26</sup> At the time, the ESA had nine European partners: Belgium, Denmark, France, Germany, Italy, the Netherlands, Norway, Spain and the United Kingdom.

<sup>27</sup> 1988 IGA, *supra* note 25, art. 1, para. 2. In conjunction with the 1988 IGA, three bilateral Memoranda of Understanding (MOUs) were executed between NASA and the space agencies of the other signatories of the agreement, setting out the details of the cooperative effort. See Memorandum of Understanding Between the United States National Aeronautics and Space Administration and the European Space Agency on Cooperation in the Detailed Design, Development, Operation, and Utilization of the Permanently Manned Civil Space Station, Sept. 29, 1988, reprinted in 4 U.S. SPACE LAW, *supra* note 25, § II.A.22(a) (Jan. 1989); and Memorandum of Understanding Between the United States National Aeronautics and Space Administration and the Ministry of State for Science and Technology [MOSST] of Canada on Cooperation in the Detailed Design, Development, Operation, and Utilization of the Permanently Manned Civil Space Station, Sept. 29, 1988, reprinted in 4 U.S. SPACE LAW, *supra* note 25, § II.A.22(b) (Jan. 1989) (upon establishment of the Canadian Space Agency (CSA) on Mar. 1, 1989, it assumed responsibility for execution of the Canadian Space Station Program for MOSST); and Memorandum of Understanding Between the United States National Aeronautics and Space Administration and the Government of Japan on Cooperation in the Detailed Design, Development, Operation, and Utilization of the Permanently Manned Civil Space Station, Mar. 14, 1988, reprinted in 4 U.S. SPACE LAW, *supra* note 25, § II.A.22(c) (May 1990).

*purposes, in accordance with international law,” in order to “enhance the scientific, technological, and commercial use of space.”<sup>28</sup>*

The demise of the Soviet Union brought about a dramatic warming of the world political climate in the early 1990s and ushered in a new era of unprecedented cooperation among nations in outer space matters. In this new spirit of cooperation, the Russian Federation was extended an invitation to join the ISS project in December 1993.<sup>29</sup> In addition to possible “political” considerations,<sup>30</sup> Russian involvement in the program was expected to bring significant cost savings, experience in space station management and prolonged human spaceflight, and access to reliable heavy-lift launch vehicles.<sup>31</sup> Formal negotiations on a protocol to amend the 1988 IGA to add the Russian Federation to the ISS partnership commenced in April 1994,<sup>32</sup> and on June 23, 1994, NASA and the Russian Space Agency (RSA) reached an interim agreement on Russian participation in “the Space Station Program” pending the conclusion of a protocol to the 1988 IGA.<sup>33</sup> Although Russia became a full partner in the ISS in July 1996, renegotiation of the terms of the 1988 IGA continued, until finally, after almost five years of negotiating, the representatives of the United States, Russia, Canada, Japan, and the eleven member states of the ESA, concluded the Intergovernmental Agreement of 1998 (1998 IGA) on January 29, 1998.<sup>34</sup>

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<sup>28</sup> Emphasis added. 1988 IGA, *supra* note 25, art. 1, para. 1.

<sup>29</sup> The invitation to the Russian Federation to become a Partner in the Space Station was extended on Dec. 6, 1993, and accepted on Dec. 17, 1993. 1998 IGA, *supra* note 20, Preamble; *see also* Moenter, *supra* note 24, at 1034; and Jesse B. Ashe, III, *Space Station Alpha: International Shining Star or Legal Black Hole?*, 9 TEMP. INT’L & COMP. L.J. 333 (1995).

<sup>30</sup> “Critics suggest that the station is politically driven to reward the Russians for backing out of missile technology sales to developing countries.” Ashe, *supra* note 29, at 335 (citing John M. Logsdon & Alain Dupas, *Lessons to be Learned from Space Station Saga*, AVIATION WK. & SPACE TECH., Mar. 7, 1994, at 52); *see also* Frank Moring, Jr., *Tito Trip Strains ISS Partnership*, AVIATION WK. & SPACE TECH., May 14, 2001, at 79 (quoting statements of U.S. Senator Milkuski indicating Russia had reneged on its “deal” with the United States concerning cooperation on the ISS project by continuing to sell missile “technology and know-how” to Iran).

<sup>31</sup> *See* Ashe, *supra* note 29, at 334-35; *see also* Moenter, *supra* note 24, at 1034.

<sup>32</sup> *See* U.S.-Russian Joint Commission on Economic and Technological Cooperation—Joint Statement on Space Station Cooperation, Jun. 23, 1994, U.S.-U.S.S.R., in 4 U.S. SPACE LAW, *supra* note 25, § II.B. Russian Federation, at 16-17 (Oct 1994).

<sup>33</sup> Interim Agreement Between the National Aeronautic and Space Administration of the United States and the Russian Space Agency for the Conduct of Activities Leading to a Russian Partnership in the Detailed Design, Development, Operation, and Utilization of the Permanently Manned Civil Space Station, Jun. 23, 1994, U.S.-U.S.S.R., in 4 U.S. SPACE LAW, *supra* note 25, § II.B. Russian Federation (cont.) (Sept. 1995).

<sup>34</sup> Moenter, *supra* note 24, at 1034.

Upon entering into force on March 27, 2001, the 1998 IGA replaced the 1988 agreement.<sup>35</sup> Like its predecessor, the object of the 1998 Agreement –

is to establish a long-term international cooperative framework among the Partners, on the basis of genuine partnership, for the detailed design, development, operation and utilization of a permanently inhabited civil international Space Station.<sup>36</sup>

The express purpose of the Space Station likewise remained unchanged under the 1998 agreement; *i.e.*, the ISS is to be a “civil space station” used for “peaceful purposes,” in order to “enhance the scientific, technological, and commercial use of outer space.”<sup>37</sup> However, under the new agreement, the Russian and American space station programs are merged;<sup>38</sup> therefore, the ISS is no longer to be based on a “core U.S. Space Station.” Instead, the 1998 agreement provides for the United States and Russia to co-produce the “foundational elements” of the facility, which will then be significantly enhanced by additional elements produced by “the European Partner,” Japan, and Canada, to create “an integrated international Space Station.”<sup>39</sup>

### A. Management

Although the 1998 IGA gives the United States “the lead role” in overall management of the ISS,<sup>40</sup> the agreement provides for participation of all five Partners in the management of the integrated facility,<sup>41</sup> with “decision-making by consensus” being the goal.<sup>42</sup> This multilateral management function is performed by the ISS Multilateral Coordination Board (MCB), which is comprised of representatives of NASA, ESA, CSA, RSA and Japan’s

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<sup>35</sup> 1998 IGA, *supra* note 20, art. 25, para. 4. The 1988 IGA had only entered into force for the United States and Japan. See Moenter, *supra* note 24, at 1035.

<sup>36</sup> 1998 IGA, *supra* note 20, art. 1, para. 1; compare 1988 IGA, *supra* note 25, art. 1, para. 1.

<sup>37</sup> 1998 IGA, *supra* note 20, art. 1, para. 1; see also art. 14, para. 1 (“The Space Station together with its additions of evolutionary capability shall remain a civil station, and its operation and utilization shall be for peaceful purposes, in accordance with international law.”).

<sup>38</sup> See Moenter, *supra* note 24, at 1034.

<sup>39</sup> 1998 IGA, *supra* note 20, art. 1, para. 2.

<sup>40</sup> *Id.* art. 1, para. 2, and art. 7, para. 2.

<sup>41</sup> The IGA makes a distinction between “Partner States” and “Partners”—there are *fifteen* Partner States but only *five* Partners in the project because the eleven European States are grouped, for purposes of conducting this cooperation, under the umbrella designation of the “European Partner.” André Farand, Legal Environment for Exploitation of the International Space Station, Presentation to the International Symposium at Strasbourg, France (May 26-28, 1999), in INTERNATIONAL SPACE STATION: THE NEXT MARKET PLACE 141, 142 (G. Haskell & M. Rycroft eds., 2000).

<sup>42</sup> 1998 IGA, *supra* note 20, art. 1, para. 3, and art. 7, para. 1.

Science and Technology Agency (STA), with the NASA representative serving as Chairman.<sup>43</sup>

The MCB meets periodically, or at the request of any Partner, to coordinate on matters “affecting the safe, efficient and effective utilization” of the Space Station.<sup>44</sup> In cases where consensus cannot be reached on a matter within the MCB’s purview, the Chairman may unilaterally render a decision.<sup>45</sup> However, the decision of the MCB Chairman does not affect the right of any Partner to submit the matter for consultations;<sup>46</sup> moreover, pending resolution of the issue through consultations, a partner has the right not to implement the Chairman’s decision with respect to its space station elements.<sup>47</sup> The MCB Chairman may not, however, issue a unilateral decision where the lack of consensus relates to a matter outside the MCB’s purview, *e.g.*, “an issue *not* primarily technical or programmatic in nature, including such issues with a political aspect.” Rather, resolution of such matters is to be pursued through consultation among the designated officials of the Partners concerned.<sup>48</sup>

In addition to the formal procedures for multilateral management of the Space Station set forth in the Memoranda for Understanding (MOU), Article 23 of the 1998 IGA gives Partners (acting through their Cooperating Agencies) the right to request consultations with each other on “any matter arising out of Space Station cooperation” and exhorts the Partner of whom consultations are requested to “accede to such request promptly.”<sup>49</sup> Partners are further directed to use their “best efforts” to settle disagreements, either through the MOU procedures for multilateral management or consultation.<sup>50</sup> If an issue cannot be resolved through consultations, Article 23 authorizes, but does not require, Partners to submit the matter to “an agreed form of dispute resolution such as conciliation, mediation, or arbitration.”<sup>51</sup>

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<sup>43</sup> See, Memorandum of Understanding Between the National Aeronautic and Space Administration of the United States of America and the European Space Agency concerning Cooperation on the Civil International Space Station, Jan. 29, 1998, art. 8.1.b, *in* 4 U.S. SPACE LAW, *supra* note 25, § II.A.22(g) (May 1998) [hereinafter NASA-ESA MOU].

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*; 1998 IGA, *supra* note 20, art. 7, para. 1 (“Mechanisms for decision-making... where it is not possible to reach a consensus are specified in the MOUs.”).

<sup>46</sup> NASA-ESA MOU, *supra* note 43, art. 8.1.b and art. 18; 1998 IGA, *supra* note 20, art. 23, para. 1 (“Partners... may consult with each other on any matter arising out of Space Station cooperation.”).

<sup>47</sup> NASA-ESA MOU, *supra* note 43, art. 8.1.b.

<sup>48</sup> *Id.* art. 8.1.b. and art. 18 (under Article 18 of the MOU, questions concerning the interpretation or implementation of the MOUs entered into in conjunction with the 1998 IGA are likewise to be resolved through consultations).

<sup>49</sup> 1998 IGA, *supra* note 20, art. 23, para. 1-2.

<sup>50</sup> *Id.* art. 23, para. 2.

<sup>51</sup> *Id.* art. 23, para. 4.



## B. Utilization

The basic principles for utilization of the Space Station are laid down in Article 9.1 of the 1998 IGA:

Utilization rights are derived from Partner provision of user elements, infrastructure elements, or both. Any Partner that provides Space Station user elements shall retain use of those elements, except as otherwise provided for in this paragraph. Partners which provide resources to operate and use the Space Station, which are derived from their Space Station infrastructure elements, shall receive in exchange a fixed share of the use of certain user elements.<sup>52</sup>

In other words, under Article 9.1, each Partner retains use of the “user elements” (*i.e.*, the modules containing laboratory workspace or crew member accommodations)<sup>53</sup> that it provides, *plus*, in exchange for providing “infrastructure elements” that supply resources necessary for space station operations as a whole,<sup>54</sup> a Partner also receives a share of the use of “user elements” provided by the other Partners.<sup>55</sup> Accordingly, each Partner’s share of the use of the Space Station’s “user elements” (or “user accommodations”) is expressed in fixed percentage in the MOU, as follows:

- NASA retains the use of 97.7% of the user accommodations on its laboratory modules and 97.7% of the use of its accommodation sites for external payloads, and receives the use of 46.7% of the user accommodations on the European pressurized laboratory and 46.7% of the user accommodations on the Japanese Experiment Module (JEM);
- RSA retains the use of 100% of the user accommodations on its laboratory modules and 100% of the use of its accommodation sites for external payloads;
- ESA retains the use of 51% of the user accommodations on its laboratory module;
- the GOJ retains the use of 51% of the user accommodations on its laboratory module; and

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<sup>52</sup> *Id.* art. 9, para. 1.

<sup>53</sup> Also referred to as “user accommodations.” See NASA-ESA MOU, *supra* note 43.

<sup>54</sup> *E.g.*, Communication systems; guidance and propulsion systems; systems that provide water, power, etc. See MUSEUM OF SCIENCE AND INDUSTRY, INTERNATIONAL SPACE STATION: RUSSIAN SERVICE MODULE (2000), at [http://www.msichicago.org/events/iss/pages\\_iss/zvezda.html](http://www.msichicago.org/events/iss/pages_iss/zvezda.html).

<sup>55</sup> See 1998 IGA, *supra* note 20, art. 9, para. 1.

- CSA will have the equivalent of 2.3% of the Space Station user accommodations provided by NASA, ESA and the GOJ.<sup>56</sup>

Within these limits, each Partner determines for itself how to best utilize its respective allocation,<sup>57</sup> and, under Article 9.3, each Partner is generally free to use and/or select users for its allocation for any purpose which is not inconsistent with the terms of the IGA.<sup>58</sup> However, there are two significant limitations on the freedom of ISS Partners in this regard. First, Article 9.3(a) prohibits use of a user element by a non-Partner or a private entity under the jurisdiction of a non-Partner without prior notification to and timely consensus of all of the Partners.<sup>59</sup> Second, Article 9.3(b) provides that the decision as to whether a contemplated use of an element of the Space Station is for “peaceful purposes” shall be made by the Partner that is providing the element in question.<sup>60</sup> In the context of the present discussion, this second caveat is clearly important, because it places the decision of whether a particular use of the Space Station is for “peaceful purposes” outside the scope of the ISS “consensus management” regime.

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<sup>56</sup> NASA-ESA MOU, *supra* note 43, art. 8.3.a. To avoid a debate on the relative value of the utilization and infrastructure elements supplied by Russia as a proportion of the Space Station as a whole, it was decided that Russia would keep 100% utilization of its own modules. In other words, Russia waived any claim it had to a share of the use of the elements provided by the other Partners by virtue of its contribution to the Space Station’s infrastructure, in exchange for being granted exclusive use of its own elements. This arrangement effectively placed the infrastructure element supplied to the Space Station by Russia for its own benefit and that of the other Partners on a par with that furnished by the United States, so as to enable Russia to accumulate 100% of the utilization rights in its own modules. The four founding Partners were thereby able to retain the percentages agreed to for sharing of resources with respect to the original elements (U.S.A.: 76.6%, Japan: 12.8%; Europe: 8.3%; Canada: 2.3%). Farand, *supra* note 41, at 147.

<sup>57</sup> 1998 IGA, *supra* note 20, art. 7, para. 3.

<sup>58</sup> *Id.*, art. 9, para. 3. Article 9, paragraph 4, provides: “[i]n its use of the Space Station, each Partner... is to avoid causing serious adverse effects on the use of the Space Station by the other Partners.”

<sup>59</sup> *Id.* art. 9, para. 3(a). Notably, the notice and consensus requirements do not apply to use of the ISS by a private entity under the jurisdiction of a fellow Partner state, *à la* Russia’s sale of a 6-day flight onboard the Space Station Alpha to American Dennis Tito (Apr. 30-May 5, 2001) over the objections of the United States and the other Partners; though, ultimately, the Russians did request and receive an “exemption” to the requirement for MCB coordination for the Tito flight. *See* Moring, *supra* note 30, at 79.

<sup>60</sup> 1998 IGA, *supra* note 20, art. 9, para. 3(b).

### C. Jurisdictional Framework

While the Outer Space Treaty bars the extraterrestrial extension of State sovereignty,<sup>61</sup> certain functional aspects of sovereignty nevertheless do apply in outer space.<sup>62</sup> Accordingly, the 1998 IGA allocates jurisdiction and control of the individual elements of the ISS to the Partner that provides the element based on the customary international legal principles of territoriality and nationality.<sup>63</sup>

Under Article 5 of the agreement, each Partner registers the Space Station elements it provides as space objects, in accordance with the 1976 Registration Convention.<sup>64</sup> Article 5 further provides that—each Partner shall retain jurisdiction and control over the elements it registers... and over personnel in or on the Space Station who are its nationals. The exercise of such jurisdiction and control shall be subject to any relevant provisions of this Agreement, the MOUs, and the implementing arrangements, including relevant procedural mechanisms established herein.<sup>65</sup>

The 1998 IGA, thus, allows each Partner to treat the Space Station elements carried on its registry as extensions of its territory for jurisdictional purposes and ensures that its national laws can apply to elements and personnel that it provides to the project.<sup>66</sup>

### D. Applicability of International Law

The Preamble to the 1998 IGA specifically refers to the four multilateral treaties that give force to the fundamental principles of public

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<sup>61</sup> Outer Space Treaty, *supra* note 21, art. II.

<sup>62</sup> *Id.* art. VIII; *see, e.g., infra* text accompanying notes 129-38 (on the application of the right of self-defense in outer space).

<sup>63</sup> *See* Mary B. McCord, *Responding to the Space Station Agreement: The Extension of U.S. Law into Space*, 77 GEO. L.J. 1933, 1938-39 (1989) (discussing the similar jurisdictional framework of the 1988 IGA) (“The territoriality principle allows a state to exercise jurisdiction with respect to acts occurring in whole or in part within its territory, or acts having or intended to have a substantial effect within its territory. The nationality principle allows a state to prescribe law with respect to the activities, status, interests, or relations of its nationals, both within and without its territory.” (citing RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 402(2)-(3) (1986)) (footnotes omitted); *see also* Farand, *supra* note 41, at 141 (“The general rule is that a State can exercise its control and jurisdiction only in its territory and in its air space; the IGA therefore constitutes the basis on which the signatory States are allowed to extend their national jurisdictions and controls to a facility located in outer space.”).

<sup>64</sup> 1998 IGA, *supra* note 20, art. 5, para. 1; Convention on the Registration of Objects Launched into Outer Space, Jan., 14, 1975, art. II, U.N. GAOR, 29th Sess., Supp. No. 31, at 16, U.N. Doc. A/9631 (1975), 28 U.S.T. 695, 1975 U.S.T. LEXIS 552 [hereinafter Registration Convention].

<sup>65</sup> *Id.* art. 2, para. 1.

<sup>66</sup> *See* Farand, *supra* note 41, at 141.

international space law: namely the 1967 Outer Space Treaty,<sup>67</sup> the 1968 Rescue Agreement,<sup>68</sup> the 1972 Liability Convention,<sup>69</sup> and the 1975 Registration Convention.<sup>70</sup> Article 1 decrees that the “design, development, operation and utilization” of the ISS shall take place “in accordance with international law.”<sup>71</sup> In addition, Article 2 of the Agreement provides that space station activities must comply with the treaties governing the use of outer space, as well as with general principles of international law (including customary law), wherein it states:

The Space Station shall be developed, operated, and utilized in accordance with international law, including the Outer Space Treaty, the Rescue Agreement, the Liability Convention, and the Registration Convention.<sup>72</sup>

Utilization and operation of the ISS must therefore be “seen and interpreted in the light of the aforementioned international agreements, treaties and conventions—the current law of Outer Space.”<sup>73</sup>

### III. THE LAW OF OUTER SPACE (*CORPUS JURIS SPATIALIS*)

The fundamental principles of public international space law can be found in six multilateral treaties: 1963 Limited-Test-Ban Treaty,<sup>74</sup> 1967 Outer Space Treaty,<sup>75</sup> 1968 Rescue Agreement,<sup>76</sup> 1972 Liability Convention,<sup>77</sup> 1975 Registration Convention,<sup>78</sup> and 1979 Moon Treaty.<sup>79</sup> As previously

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<sup>67</sup> Outer Space Treaty, *supra* note 21.

<sup>68</sup> Agreement on the Rescue of Astronauts, the Return of Astronauts and the Return of Objects Launched into Outer Space, Apr. 22, 1968, U.N. GAOR, 22nd Sess., Supp. No. 16, at 5, U.N. Doc. A/6716 (1968), 19 U.S.T. 7570, 1968 U.S.T. LEXIS 584 [hereinafter Rescue Agreement].

<sup>69</sup> Convention on International Liability for Damages Caused by Space Objects, Mar. 29, 1972, U.N. GAOR, 26th Sess., Supp. No. 29, at 25, U.N. Doc. A/8429 (1972), 24 U.S.T. 2389, 1972 U.S.T. LEXIS 262 [hereinafter Liability Convention].

<sup>70</sup> Registration Convention, *supra* note 64.

<sup>71</sup> 1998 IGA, *supra* note 20, art. 1, para. 1.

<sup>72</sup> *Id.* art. 2, para. 1.

<sup>73</sup> Moenter, *supra* note 24, at 1038.

<sup>74</sup> Treaty Banning Nuclear Weapon Tests in the Atmosphere, in Outer Space and Under Water, Aug. 5, 1963, 14 U.S.T. 1313, 1963 U.S.T. LEXIS 257 (ratified by the United States on Oct. 7, 1963; entered into force on Oct. 10, 1963) [hereinafter Limited-Test-Ban Treaty].

<sup>75</sup> Outer Space Treaty, *supra* note 21.

<sup>76</sup> Rescue Agreement, *supra* note 68.

<sup>77</sup> Liability Convention, *supra* note 69.

<sup>78</sup> Registration Convention, *supra* note 64.

<sup>79</sup> Agreement Governing the Activities of States on the Moon and Other Celestial Bodies, Dec. 18, 1979, U.N. GAOR, 34th Sess., Supp. No. 46, at 77, U.N. Doc. A/34/46 (1980), 18 I.L.M. 1434 [hereinafter Moon Treaty]. The Moon Treaty entered into force among its signatories in 1984, yet, it has not been ratified by the United States or any other major space power and so is viewed as having “no real significance in establishing international space law.” Glenn H. Reynolds, *The Moon Treaty: Prospects for the Future*, 11 SPACE POLICY 115 (1995); *see*

mentioned, only four of these are expressly referenced in the 1998 IGA,<sup>80</sup> however, as reflected in Articles 1 and 2 of the agreement, the ISS is subject to international law. Moreover, to the extent that an ISS Partner is a party to any of these treaties, such treaties will, pursuant to Article 5 of the IGA, govern the elements and personnel that are provided to the project.<sup>81</sup> Therefore, a brief discussion of each of the treaties governing the use of outer space is appropriate.

### A. Limited-Test-Ban Treaty (1963)

The Limited-Test-Ban Treaty was the first treaty concerning the legal regulation of the activities of states in the exploration and use of outer space.<sup>82</sup> The treaty is not concerned with outer space *per se*, but rather addresses activity in outer space as part of a more general subject—*i.e.*, the prevention of global nuclear contamination.<sup>83</sup> It is perhaps for this reason that the treaty is sometimes over-looked as a part of the “*corpus juris spatialis*.”<sup>84</sup> In any case, the Limited-Test-Ban Treaty forbids State parties from carrying out the explosion of nuclear devices in the oceans, atmosphere, or outer space.<sup>85</sup> Notably, the two powers that lead the world in both nuclear weapons and space technology, namely the United States and the Russian Federation, are both party to the treaty, together with Great Britain and more than 120 other nations. Conversely, other nuclear powers, most notably France and China, have rejected the treaty as the “selective rapprochement” of the two former Cold

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OUTER SPACE: PROBLEMS OF LAW AND POLICY 116 (Glenn H Reynolds & Robert P. Merges, eds., 2d ed. 1997) (“[A]bsent adoption by the major space powers, the Moon treaty is unlikely to play a major role in the future”) [hereinafter Reynolds & Merges]; and Kurt Anderson Baca, *Property Rights in Outer Space*, 58 J. AIR L. & COM. 1041, 1069 (1993) (stating that the Moon Treaty is not binding as a treaty and “the claim that it represents customary law is probably not credible”); cf. Michael Bourbonniere & Loius Haeck, *Jus in Bello Spatiale*, 25 AIR & SPACE L. 2, 4 (2000) (includes the Moon Treaty in the six multilateral treaties that make up space law); and BRUCE A. HURWITZ, *THE LEGALITY OF SPACE MILITARIZATION 2* (Elsevier Science Publishing Co. 1986) (“[S]pace law... is composed of five treaties... [including] the 1979 Moon Treaty”); and David Everett Marko, *A Kinder Gentler Moon Treaty: A Critical Review of the Current Moon Treaty and a Proposed Alternative*, 8 J. NAT. RESOURCES & ENVTL. L. 293 (1993) (“[The Moon Treaty is] one of the five stars in the constellation of space law.”).

<sup>80</sup> See 1998 IGA, *supra* note 20, Preamble & art. 2, para. 1.

<sup>81</sup> *Id.* art. 5, para. 2; see also *supra* text accompanying notes 61-64.

<sup>82</sup> MAURICE N. ANDEM, *INTERNATIONAL LEGAL PROBLEMS IN THE PEACEFUL EXPLORATION AND USE OF OUTER SPACE* 43 (Univ. of Lapland Publ'ns 1992).

<sup>83</sup> Limited-Test-Ban Treaty, *supra* note 74, Preamble.

<sup>84</sup> See, e.g., sources cited *supra* note 79.

<sup>85</sup> Limited-Test-Ban Treaty, *supra* note 74, art. I. “A careful reading of this provision shows that nuclear explosions are prohibited in all environments except underground tests carried out within the territorial limits of the parties to the Treaty.” Nicholas M. Matte, *The Treaty Banning Nuclear Weapons Tests in the Atmosphere, in Outer Space and Under Water (10 October 1963) and the Peaceful Uses of Outer Space*, 9 ANNALS OF AIR & SPACE L. 391, 401 (1984).

War adversaries and have continued their altitude nuclear tests.<sup>86</sup> As a result, the impact of the Limited-Test-Ban Treaty is somewhat limited and, as the International Court of Justice (ICJ) decision in the Nuclear Test Case<sup>87</sup> suggests, the treaty's prohibitions likely cannot be regarded as declaratory of general international law.<sup>88</sup> Nevertheless, the Limited-Test-Ban Treaty stands as the first legally binding document renouncing a military use of outer space,<sup>89</sup> and was also the first step towards the "denuclearization of outer space."<sup>90</sup> The provisions of the Limited-Test-Ban Treaty apply to Space Station activities inasmuch as all ISS Partner States, apart from France, are parties to the treaty.<sup>91</sup>

## B. Outer Space Treaty (1967)

In 1958, shortly after the launching of Sputnik I, the United Nations General Assembly formed an *ad hoc* Committee on the Peaceful Uses of Outer Space (COPUOS),<sup>92</sup> and, the following year, COPUOS was established as a permanent body.<sup>93</sup> Since its inception, COPUOS has overseen the development of five international space treaties which have all entered into force.<sup>94</sup> The first and, by far, the most significant of these treaties was the 1967 Outer Space Treaty. This agreement is considered to be the foundation for international legal order in outer space,<sup>95</sup> and it is binding on all of the ISS

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<sup>86</sup> Matte, *supra* note 85, at 405.

<sup>87</sup> Nuclear Test Case (Austl. v. Fr.), 1974 I.C.J. 253 (Dec. 20).

<sup>88</sup> See BIN CHENG, *Outer Space: The International Legal Framework—the International Legal Status of Outer Space, Space Objects, and Spacemen*, Lectures delivered at the Institute of Public International Law and International Relations, University of Thessaloniki (Sept. 1979), in 10 *THE SAURUS ACROASIAM* 41 (1981), reprinted in *STUDIES IN INTERNATIONAL SPACE LAW* 383, 408-9 (Clarendon Press 1997) [hereinafter *STUDIES IN SPACE LAW*].

<sup>89</sup> See Reynolds & Merges, *supra* note 79, at 52.

<sup>90</sup> G.S. Raju, *Military Use of Outer Space: Towards Better Legal Controls*, in *MAINTAINING OUTER SPACE FOR PEACEFUL PURPOSES* 90, 92 (Nandasiri Jasentuliyana ed., 1984) (Proceedings of a Symposium held in The Hague, Mar. 1984) [hereinafter *PEACEFUL PURPOSES*].

<sup>91</sup> See Galloway in *SPACE STATIONS*, *supra* note 10, at 42.

<sup>92</sup> Question of the peaceful use of outer space, G.A. Res. 1348, U.N. GAOR, 13th Sess., Supp. No. 18, at 5, U.N. Doc. A/4090 (1959) [hereinafter Resolution 1348 (1958)].

<sup>93</sup> International co-operation in the peaceful uses of outer space, G.A. Res. 1472, U.N. GAOR., 14th Sess., Supp. No. 16, at 5, U.N. Doc. A/4354 (1960).

<sup>94</sup> On the role of COPUOS in the development of international space law, see Nandasiri Jasentuliyana, *The Law Making Process in the United Nations*, in *SPACE LAW: DEVELOPMENT AND SCOPE* 33 (Nandasiri Jasentuliyana ed., 1992).

<sup>95</sup> Nandasiri Jasentuliyana, *A Survey of Space Law as Developed by the United Nations*, in *PERSPECTIVES ON INTERNATIONAL LAW* 349, 359 (N. Jasentuliyana ed., 1995) [hereinafter *PERSPECTIVES ON INT'L L.*]. For detailed historical and legal analysis of the Outer Space Treaty, see Paul G. Dembling, *Treaty on Principles Governing the Activities of States in the Exploration and Use of Outer Space, Including the Moon and Other Celestial Bodies*, in 1 *MANUAL ON SPACE LAW* 1 (Nandasiri Jasentuliyana & Roy S.K. Lee eds., 1979).

Partner States as public international law.<sup>96</sup> The first three articles of the Outer Space Treaty establish the framework for the peaceful exploration and use of outer space, from which the basic elements of space law are derived: the common interest principle (Article I), the freedom principle (Article I), the nonappropriation principle (Article II), and the application of international law and the U.N. Charter to outer space (Article III).<sup>97</sup>

### *I. Article I*

Like many of the principles set forth in the Outer Space Treaty, the common interest principle had been previously advanced in a variety of forms.<sup>98</sup> By 1951, developments in high altitude rocket flight were such that the launching of earth satellites was imminent; thus, there was increased discussion among legal scholars about the notion of an upper boundary in space to the territory of the subjacent State.<sup>99</sup> In 1952, Oscar Schachter predicted that—

outer space and the celestial bodies would be the common property of all mankind, over which no nation would be permitted to exercise domination... [and] a legal order would be developed on the principle of free and equal use, with the object of furthering scientific research and investigation.<sup>100</sup>

Subsequently, in 1958, in its first resolution dealing specifically with outer space, the United Nations General Assembly expressly recognized the principle of “the common interest of mankind in outer space.”<sup>101</sup> This notion

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<sup>96</sup> See Moenter, *supra* note 24, at 1038 (citing Bin Cheng, *1967 Outer Space Treaty: Thirtieth Anniversary*, 23 AIR & SPACE LAW 156 (1998)). The Outer Space Treaty currently binds over 100 signatories; yet, the question of whether the legal principles of the treaty have become a part of customary international law and thereby apply to all States remains controversial. See Ram S. Jakhu, Application and Implementation of the 1967 Outer Space Treaty (Presentation to the American Institute of Aeronautics and Astronautics (AIAA) Legal Symposium Celebrating the 30th Anniversary of the 1967 Outer Space Treaty (1997)) (on file with author).

<sup>97</sup> Jasentuliyana in PERSPECTIVES ON INT’L L., *supra* note 95, at 359.

<sup>98</sup> Paul G. Dembling & Daniel M. Arons, *The Evolution of the Outer Space Treaty*, 33 J. AIR L. & COM. 419, 420 (1967).

<sup>99</sup> C. WILFRED JENKS, SPACE LAW 97 (Fredrick A. Praeger 1965); see, e.g., JOHN COBB COOPER, High Altitude Flight and National Sovereignty, Address Delivered at the Escuela Libre de Derecho, Mexico City (Jan. 5, 1951), in EXPLORATIONS IN AEROSPACE LAW 256, 263 (Ivan A. Vlasic ed., 1968) [hereinafter AEROSPACE LAW] (“[I]t is obvious we must agree there is an upper boundary in space to the territory of the subjacent State. Under no possible theory can it be said that a State can exercise sovereign rights in outer space beyond the region of the earth’s attraction.”).

<sup>100</sup> Quoted in JENKS, *supra* note 99, at 97.

<sup>101</sup> Resolution 1348 (1958), *supra* note 92.

was thereafter carried forward into Article I of the Outer Space Treaty,<sup>102</sup> which reads:

The exploration and use of outer space, including the moon and other celestial bodies, shall be carried out for the benefit and interests of all countries, irrespective of their degree of economic or scientific development, and shall be the province of all mankind.

Outer space, including the moon and other celestial bodies, shall be free for exploration and use by all States without discrimination of any kind, on a basis of equality and in accordance with international law, and there shall be free access to all areas of celestial bodies.

There shall be freedom of scientific investigation in outer space, including the moon and other celestial bodies, and States shall facilitate and encourage international cooperation in such investigation.

The legal significance of the “common interest” principle is subject to debate. One view equates the “common interest” principle to “the equitable sharing of whatever benefits may be gathered from the exploration and use of outer space—equitably, that is, not only between States operating in outer space, but also taking into account those states not so technologically advanced.”<sup>103</sup> So, for example, under this theory a State whose economy is not adequate to finance a space program may, nevertheless, rightfully share in the benefits of the use of outer space by registering orbital positions in the geostationary orbit (a limited resource)<sup>104</sup> and then gaining revenue by leasing the positions.<sup>105</sup> The principle of “equitable sharing of the benefits” of the

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<sup>102</sup> See also Outer Space Treaty, *supra* note 21, Preamble. The Preamble to the Outer Space Treaty recalls the language of Resolution 1348 wherein it recognizes “the common interest of all mankind in the progress of the exploration and use of outer space for peaceful purposes.”

<sup>103</sup> BESS C.M. REIJNEN, *THE UNITED NATIONS SPACE TREATIES ANALYSED* 89 (Editions Frontières 1992).

<sup>104</sup> The geostationary satellite orbit is 22,300 miles above the Earth’s surface, at which height a satellite revolves around the Earth at the same speed as the ground below and, thus, it appears to remain stationary over a given point on the Earth’s surface; it is the only satellite orbit which is specifically deemed to be a “limited natural resource” under Article 33(2) of the Convention of the International Telecommunication Union, Dec. 22, 1992, S. Treaty Doc. No. 104-34 (1996) (as amended through 1994) [hereinafter ITU Convention]. See Ram S. Jakhu, *The Legal Status of the Geostationary Orbit*, 7 *ANNALS OF AIR & SPACE L.* 333, 349-350 (1982); Final Acts of the Additional ITU Plenipotentiary Conference, Geneva, 1992, available at <http://www.wia.org/pub/itu-constitution.html>.

<sup>105</sup> From 1988-90, Tonga, a tiny Pacific nation, submitted filings for sixteen geostationary satellite orbital (GSO) positions over the Pacific Ocean. The five member nations of the International Telecommunications Satellite Organization (INTELSAT) protested to the International Frequency Registration Board (IFRB), on the ground that the acquisition was for profit only and did not further the IFRB goal of maximizing international communications access. Eventually, a compromise was reached whereby Tonga relinquished all but six of the GSO slots. See Jonathan Ira Ezor, *Costs Overhead: Tonga’s Claiming of Sixteen Geostationary Orbital Sites and the Implications for U.S. Space Policy*, 24 *LAW & POL’Y INT’L BUS.* 915 (1993); and Francis Lyall, *Expanding Global Communication Services*, Discussion Paper Presented at the Workshop of Space Law in the 21st Century (Jul. 1999)



exploration and use of outer space might also be interpreted so as to require international taxation on profits made from the commercial extraction of natural resources from the Moon, Mars and asteroids (once such exploitation becomes possible), or a mandatory transfer of the technology used to exploit these resources to the so-called “space have-nots.”<sup>106</sup>

In practice, however, the common interest principle has predominantly been interpreted as assuring only “equitable access” to outer space and its benefits for those States having the requisite technology and financial resources.<sup>107</sup> The International Telecommunications Union (ITU) Convention, for instance, states that radio frequencies and the geostationary orbit “must be used efficiently and economically so that countries or groups of countries may have *equitable access* to both.”<sup>108</sup>

Similarly, in the case of remote sensing, the U.N. declaration of Principles Relating to Remote Sensing of the Earth from Outer Space (1986)<sup>109</sup> basically repeats the language of Article I, paragraph 1, of the Outer Space Treaty, wherein it provides that—

[r]emote sensing activities shall be carried out for the benefit and in the interests of all countries, irrespective of their degree of economic, social, or scientific and technological development, and taking into particular consideration the needs of the developing countries.

But under Principle XII, the sensed State is again only assured of *access* to the remote sensing data, albeit “on a non-discriminatory basis and on reasonable cost terms.”<sup>110</sup> In practical terms, this means that (at a minimum) the data will be made available to the sensed State at “market rates,” though without any guarantee of uniform pricing.<sup>111</sup>

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(criticizing Tonga’s claim to sixteen geostationary orbital sites as a “homestead claim which might or might not eventually produce gold” and “an undesirable abuse of the ITU system”) (on file with author).

<sup>106</sup> Art Dula, *Free Enterprise and the Proposed Moon Treaty*, 2 Hous. J. Int’l L. 3, 33 (1979), reprinted in Reynolds & Merges, *supra* note 79, at 14; see also REIJNEN, *supra* note 103, at 16-17.

<sup>107</sup> See REIJNEN, *supra* note 103, at 16.

<sup>108</sup> ITU Convention, *supra* note 104, art. 33(2) (emphasis added).

<sup>109</sup> Principles Relating to Remote Sensing of the Earth from Outer Space, Principle II, U.N. GAOR, 41st Sess., Supp. No. 53, at 115, U.N. Doc. A/41/53 (1986).

<sup>110</sup> See also Land Remote Sensing Policy Act of 1992, 15 U.S.C. § 5601 et seq. (1992); and Proposed Rules for Licensing of Private Land Remote-Sensing Space Systems, 62 Fed. Reg. 59,317, 59,319 (Nov. 3, 1997) (“Section 202(b)(2) of the 1992 Act requires that all licenses include the condition that the licensee shall make available to the government of any country, including the United States, unenhanced data collected by the system concerning the territory under the jurisdiction of such government on reasonable terms and conditions.”).

<sup>111</sup> See Joanne Irene Gabrynowicz, *Defining Data Availability for Commercial Remote Sensing Systems*, 23 ANNALS OF AIR & SPACE L. 93, 104 (1998) (“However, if pronounced differences [in pricing] led to *de facto* exclusion of access to data for the sensed State, then the obligation of nondiscriminatory access would be breached.”).

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Article I of the Outer Space Treaty also establishes the freedom principle, which is at once a corollary to, but also limited by, the common interest principle.<sup>112</sup> Pursuant to Article 1, paragraph 2, three “positive” aspects of the principle of freedom of outer space are established: (1) freedom of access, (2) freedom of exploration, and (3) freedom of use.<sup>113</sup> As in the case of the common interest principle, the freedom principle was also initially put forward in the form of a General Assembly Resolution; first in Resolution 1721, which was adopted on December 20, 1961,<sup>114</sup> and then again in Resolution 1962, which was adopted, on December 13, 1963.<sup>115</sup> Because these resolutions are viewed as having enunciated preexisting legal principles based on the practice of States dating back to the launching of the first satellite,<sup>116</sup> the freedom principle that is incorporated into the Outer Space Treaty is generally considered to be part of customary international law, binding on all States, regardless of whether they are actually a party to the agreement.<sup>117</sup>

## 2. Article II

Closely linked to the concepts of the common interest of mankind and the freedom of exploration and use of outer space is the principle of nonappropriation under Article II of the Outer Space Treaty.<sup>118</sup> It states:

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<sup>112</sup> The “common interest” principle, art. I, para. 1, requires that exploration and use of outer space be for the common “benefit and interest.” Other limitations imposed by the Outer Space Treaty on the freedom of use of outer space include the nondiscrimination and equity clause (art. I, para. 2), the nonappropriation clause (art. II), the international law clause (art. III), the proscription on nuclear weapons (art. IV, para. 1), the responsibility and liability clauses (art. VI and VII), and the consultation, observation, and information clauses (art. V, IX, and XI). CENTRE FOR RESEARCH OF AIR & SPACE LAW, MCGILL UNIVERSITY, SPACE ACTIVITIES AND EMERGING INTERNATIONAL LAW 270, 272 (Nicolas M. Matte ed., 1984) [hereinafter SPACE ACTIVITIES & INT’L LAW].

<sup>113</sup> *Id.* at 270.

<sup>114</sup> International Cooperation in the Peaceful Uses of Outer Space, G.A. Res. 1721, *reprinted in* JENKS, *supra* note 99, at 320.

<sup>115</sup> Declaration of Legal Principles Governing the Activities of States in the Exploration and Use of Outer Space, G.A. Res. 1962, U.N. GAOR, 18th Sess., Supp. No. 15, at 15, U.N. Doc. A/5515 (1964).

<sup>116</sup> *See*, ANDEM, *supra* note 82, at 15 (“[D]uring the launching into orbit by the Soviet Union in 1957 of the first artificial earth satellite, Sputnik-1, there was no protest in any form from any state or group of states about any violation of, or infringement on its territorial sovereignty of its air space... [t]herefore... all states established as a precedent the principle of the freedom of flight of space objects of one state over the territory (air space) of another.”).

<sup>117</sup> *See* Ivan A. Vlasic, *The Growth of Space Law 1957-65: Achievements and Issues*, in YEARBOOK OF AIR AND SPACE LAW 1965, at 365, 374-380 (René H. Mankiewicz ed., 1967).

<sup>118</sup> SPACE ACTIVITIES & INT’L LAW, *supra* note 112, at 275.

Outer space, including the moon and other celestial bodies, is not subject to national appropriation by claim of sovereignty, by means of use or occupation, or by any other means.

This restriction is a logical extension of the fundamental principles pronounced in Article I. Indeed, if outer space is to serve the common interest of all of mankind and be free for use and exploration, it obviously cannot be appropriated and, thereby, subjected to exclusive claims of sovereignty by select States.<sup>119</sup> Together, the principles reflected in Articles I and II of the Outer Space Treaty establish outer space as a *res communis* under international law;<sup>120</sup> that is to say, “space is owned by no one but is free for use by everyone.”<sup>121</sup>

However, the scope of applicability of the nonappropriation principle has at times been disputed, due to the lack of a precise boundary between air space (which is subject to the sovereignty of the subjacent State)<sup>122</sup> and outer space (which, under Article II of the Outer Space Treaty, is not).<sup>123</sup> To resolve this ambiguity, some (known as “spacialists”) have argued for the establishment of a legal boundary delineating national air space from outer space.<sup>124</sup> Nevertheless, throughout the space age, the prevailing view has been that there is no real need to establish any boundary between air space and outer space, since the absence of such a boundary has, thus far, not created any major problems, and the utmost freedom of action in the peaceful exploration and use of outer space is both necessary and desirable.<sup>125</sup> According to this

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<sup>119</sup> See *id.* (“Appropriation is incompatible with both of these principles.”); but see Declaration of the First Meeting of Equatorial Countries, Dec. 3 1976 (the Bogotá Declaration), reprinted in 2 MANUAL ON SPACE LAW 383 (Nandasiri Jasentuliyana & Roy S.K. Lee eds., 1979) (under this declaration, the eight equatorial states of Brazil, Columbia, Congo, Ecuador, Indonesia, Kenya, Uganda and Zaire, claim sovereignty over the portions of the geostationary satellite orbit (GSO) above their territory).

<sup>120</sup> See Carl Q. Christol, *Article 2 of the 1967 Principles Treaty Revisited*, 9 ANNALS OF AIR & SPACE L. 217, 217-21 (1984).

<sup>121</sup> Moenter, *supra* note 24, at 1039.

<sup>122</sup> See Convention on International Civil Aviation, Dec. 7, 1944, art. 1, 61 Stat. 1180, 3 Bevans 944, 15 U.N.T.S. 295, 1944 U.S.T. LEXIS 146 (“[E]very State has complete and exclusive sovereignty over the air space above its territory.”).

<sup>123</sup> See Jakhu, *supra* note 104, at 334 (discussing the claim made by equatorial states in the Bogotá Declaration (see *supra* note 119) that, in the absence of a lower boundary of outer space, their sovereignty extends to the part of the GSO located over their respective territories).

<sup>124</sup> See Definition and Delimitation of Outer Space, U.N. Doc. A/AC.105/484, at 22 (1991), discussed in REIJNEN, *supra* note 103, at 98; see also Approach to the Solution of the Problems of the Delimitation of Airspace and Outer Space, U.N. Doc. A/AC.105/C.2/L.121 (1979) (reissued version of Mar. 28, 1979) (working paper prepared by the Soviet Union which defined outer space as the region beyond an altitude of 100 kilometers above sea level), discussed in BIN CHENG, *The Legal Regime of Airspace and Outer Space: the Boundary Problem*, 5 ANNALS OF AIR & SPACE L. 323 (1980), reprinted in STUDIES IN SPACE LAW, *supra* note 88, at 425, *passim*.

<sup>125</sup> REIJNEN, *supra* note 103, at 98; see also CHENG, *supra* note 124, in STUDIES IN SPACE LAW, at 426-28.

latter school of thought, activities in the *aerospace continuum* (made up of air space and outer space) should be governed according to their nature, *i.e.*, aeronautical activities by aeronautical law and space activities by aerospace law.<sup>126</sup> Ergo, advocates of this second approach are referred to as “functionalists.”<sup>127</sup>

The dominance of the functionalist approach at the U.N. has, at least to date, forestalled efforts to fix a definite, though seemingly arbitrary boundary between air space and outer space.<sup>128</sup> At the same time, through state practice, the functionalist approach has led to the establishment of “functional” criteria for defining “outer space” and “space objects” which, according to Professor Bin Cheng, can be said to reflect current international law.<sup>129</sup> First, since no State has ever claimed that a satellite orbiting the earth was infringing its national airspace, it is possible to say that in international law, outer space begins *at least* from the height above the earth of the lowest perigee of any existing or past artificial satellite that has orbited the earth without encountering any protest.<sup>130</sup> Secondly, for purposes of international law, a “space object” can be defined as “an object designed and intended to penetrate into outer space [as previously defined]... whether or not in any orbit, and for whatever length of time”—correspondingly, “[o]bjects which are not designed and intended to enter outer space and which do not penetrate into outer space are not space objects.”<sup>131</sup>

### 3. Article III

The last of the aforementioned “basic legal elements of space law” established by the Outer Space Treaty is embodied in Article III. It provides that—

States Parties to the Treaty shall carry on activities in the exploration and use of outer space, including the moon and other celestial bodies, in accordance with international law, including the Charter of the United Nations, in the interest of maintaining international peace and security and promoting international cooperation and understanding.<sup>132</sup>

Article III thus makes the general principles of international law (*lex generalis*)—including rules of customary law—and the United Nations

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<sup>126</sup> Jakhu, *supra* note 104, at 337-38.

<sup>127</sup> See *id.*; see also BIN CHENG, *International Responsibility and Liability for Launch Activities*, 20 AIR & SPACE L. 297 (1995), reprinted in STUDIES IN SPACE LAW, *supra* note 88, at 598, 615.

<sup>128</sup> See CHENG, *supra* note 124, in STUDIES IN SPACE LAW, at 426-27; see also Jakhu, *supra* note 104, at 38-39 (discussing the various bases proposed for establishing the height of a boundary between air space and outer space).

<sup>129</sup> See CHENG, *supra* note 127, in STUDIES IN SPACE LAW, at 615.

<sup>130</sup> *Id.*

<sup>131</sup> *Id.*

<sup>132</sup> Outer Space Treaty, *supra* note 21, art. III.

Charter<sup>133</sup> applicable to outer space.<sup>134</sup> However, because certain rules of international law and/or provisions of the Charter cannot, by definition, apply to outer space, or are of a nature of *lex specialis* for certain environments, Article III is not an automatic extension to outer space and celestial bodies of ‘international law, including the Charter of the United Nations’ *in toto*.<sup>135</sup> Yet, there are those that have gone further and argued that since the Outer Space Treaty does not enumerate exactly which “general principles” apply to outer space, certain fundamental provisions of international law, specifically those concerning the use of force in self-defense, cannot and should not be made applicable to outer space, on the basis that they are inconsistent with the principles of the Outer Space Treaty itself.<sup>136</sup>

But while the right to use force in self-defense in outer space is perhaps not universally accepted,<sup>137</sup> the prevalent view is that Article 2(4) of the U.N. Charter<sup>138</sup> applies in outer space, and it is, therefore, unlawful for a State to interfere in a hostile manner with the assets in outer space of another State,<sup>139</sup> and that the exception to the bar on the use of force under Article 51 likewise applies in outer space, so that a State can legally use force to defend itself against hostile actions, should they nevertheless occur.<sup>140</sup> The United States

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<sup>133</sup> Charter of the United Nations, Jun. 26, 1945, 59 Stat. 1031, T.S. 993, 3 Bevens 1153, 1945 U.S.T. LEXIS 199 [hereinafter U.N. CHARTER]. Ratified by the United States on Aug. 8 1945, entered into force on Oct. 24, 1945.

<sup>134</sup> See Ivan A. Vlasic, *Space Law and the Military Applications of Space Technology*, in PERSPECTIVES ON INT’L L., *supra* note 95, at 385, 394; and REIJNEN, *supra* note 103, at 102; see also MANFRED LACHS, THE LAW OF OUTER SPACE: AN EXPERIENCE IN CONTEMPORARY LAW MAKING 14 (Sijthoff Leiden 1972) (“[Article III] obviously implies that in all their activities in regard to and within outer space and on celestial bodies States are subject to the rule of international law.”).

<sup>135</sup> LACHS, *supra* note 134, at 15.

<sup>136</sup> M. Chandrasekharan, Editorial Comment, *The Space Treaty*, 7 INDIAN J. INT’L L. 61, 63 (1967).

<sup>137</sup> See Vlasic, *supra* note 134, in PERSPECTIVES ON INT’L L., at 394; and HURWITZ, *supra* note 69, at 71 (citing Chandrasekharan, *supra* note 136, at 63).

<sup>138</sup> Article 2(4) states: “All Members shall refrain in their international relations from the threat or use of force against the territorial integrity or political independence of any state, or in any other manner inconsistent with the Purposes of the United Nations.” U.N. CHARTER, *supra* note 133.

<sup>139</sup> See Vlasic, *supra* note 134, in PERSPECTIVES ON INT’L L., at 394; and Philip D. O’Neill, Jr., *The Development of International Law Governing the Military Use of Outer Space*, in NATIONAL INTERESTS AND THE MILITARY USE OF SPACE 169, 177 (William J. Durch ed., 1984) [hereinafter NATIONAL INTERESTS]; see also Manfred Lachs, Preserving the Space Environment, Opening Address to the Symposium on the Conditions Essential for Maintaining Outer Space for Peaceful Uses (Mar. 12, 1984), in PEACEFUL PURPOSES, *supra* note 90, at 5, 7.

<sup>140</sup> “Under present treaty rules and/or customary law, as demonstrated in practice, national statements, and United Nations resolutions... [i]nternational law including the United Nations Charter where appropriate, applies to acts in outer space. This expressly includes the right of self defense.” LAY & TAUBENFELD, *supra* note 5, at 73; see also HURWITZ, *supra* note 69, at 72 (the Legal Sub-Committee of the U.N. Committee for the Peaceful Uses of Outer Space (COPUOS) has rejected the view that the right of self-defense is not applicable in regards to

has supported this view since the inception of the Outer Space Treaty,<sup>141</sup> and it remains part of current U.S. space policy.<sup>142</sup>

#### 4. Article IV

In addition to the basic elements of space law established in the first three articles of the Outer Space Treaty, Article IV of the treaty “contain[s] the first principles of international law explicitly relating to military activities in space.”<sup>143</sup> It reads as follows:

States Parties to the Treaty undertake not to place in orbit around the earth any objects carrying nuclear weapons or any other kinds of weapons of mass destruction, install such weapons on celestial bodies, or station such weapons in outer space in any other manner.

The moon and other celestial bodies shall be used by all States Parties to the Treaty exclusively for peaceful purposes. The establishment of military bases, installations and fortifications, the testing of any type of weapons and the conduct of military maneuvers on celestial bodies shall be forbidden. The use of military personnel for scientific research or for any other peaceful purposes shall not be prohibited. The use of any equipment or facility necessary for peaceful exploration of the moon and other celestial bodies shall also not be prohibited.

On its face, paragraph 1 of Article IV appears to bring to fruition the denuclearization of outer space that began with the 1963 Limited-Test-Ban Treaty—it imposes a general ban on positioning nuclear weapons and other weapons of mass destruction in orbit around the earth, on celestial bodies, or in outer space. From the outset, it is clear that since paragraph 1 of Article IV

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outer space); *and* GENNADII ZHUKOV, *INTERNATIONAL SPACE LAW* 89 (Progress Publishers 1976) (states can lawfully use force in or through outer space in the process of self-defense); J.E.S. FAWCETT, *INTERNATIONAL LAW AND THE USE OF OUTER SPACE* 39 (Manchester Univ. Press 1968) (no provision of the Charter or rule of customary law imposes “any upper limit above the surface of the Earth on the legitimate exercise of the right of self-defense.”).

<sup>141</sup> CARL Q. CHRISTOL, *THE MODERN INTERNATIONAL LAW OF OUTER SPACE* 37 (Pergamon Press 1982).

<sup>142</sup> *See* White House Fact Sheet, National Space Policy (Sept. 1, 1996), *available at* <http://ast.faa.gov/licensing/regulations/nsp-pdd8.htm> [hereinafter National Space Policy (1996)] (“National security space activities shall contribute to U.S. national security by... providing support for the United States’ inherent right of self-defense... The United States considers the space systems of any nation to be national property with the right of passage through and operations in space without interference. Purposeful interference with space systems shall be viewed as an infringement on sovereign rights.”); *see also* DODD 3100.10, *supra* note 11, para. 4.1-4.2, at 6; *and* COMMISSION TO ASSESS U.S. NATIONAL SECURITY SPACE MGMT. & ORG., REPORT PURSUANT TO P.L. 106-65, at 37 (2001), *available at* <http://sun00781.dn.net/spp/military/commission/report.htm> (“It is important to note... that by specifically extending the principles of the U.N. Charter to space, the Outer Space Treaty (Article III) provides for the right of individual and collective self-defense, including “anticipatory self-defense.”).

<sup>143</sup> Vlasic, *supra* note 134, *in* PERSPECTIVES ON INT’L L., *supra* note 95, at 396.

refers only to weapons of mass destruction, it implicitly permits the presence of other types of weapons in outer space.<sup>144</sup> Additionally, the provision was deliberately worded to permit the earthly use of intercontinental ballistic missiles (ICBMs), which incidentally pass through space, due to the fact that the national defense systems of the two major space powers were both based upon ICBMs.<sup>145</sup> However, the fact that paragraph 1 refers only to “celestial bodies” and “outer space” and not to “outer space, the moon, and other celestial bodies,” as in other provisions of the treaty, suggests that the Moon is similarly excluded from its application.<sup>146</sup> While it is unclear whether exclusion of the Moon was intentional, or merely poor draftsmanship,<sup>147</sup> the question of whether weapons of mass destruction are banned from the Moon, as well as from trajectories to and around it, is nonetheless left open to interpretation.<sup>148</sup>

Paragraph 2 of Article 4, on the other hand, establishes the principle that “the moon and other celestial bodies” shall be used “exclusively for

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<sup>144</sup> SPACE ACTIVITIES & INT’L LAW, *supra* note 112, at 292 (noting that most publicists espouse this view); *see, e.g.*, BIN CHENG, *The Commercial Development of Space: the Need for New Treaties* (Adapted from a keynote address delivered at a Seminar on The Cape York Space Port: The Legal and Business Issues, Aug. 17, 1990), 19 J. SPACE L. 17 (1991), *reprinted in* STUDIES IN SPACE LAW, *supra* note 88, at 641, 651; CHRISTOL, *supra* note 141, at 26; Nandasiri Jasentuliyana, The Moon Treaty, *in* PEACEFUL PURPOSES, *supra* note 90, at 121, 127; REIJNEN, *supra* note 103, at 98; *cf.* Vlastic, *supra* note 134, *in* PERSPECTIVES ON INT’L L., *supra* note 95, at 397 (“If one chooses to ignore the controversy concerning the ‘true’ meaning of ‘peaceful’ in the Outer Space Treaty, it is safe to conclude that the treaty permits the deployment in outer space of anti-satellite weapons, directed energy weapons, or any other kind of weapon, as long as these weapons are not in conflict with the provisions of Article IV of the Outer Space Treaty or some other agreement.”).

<sup>145</sup> *See* Raju *in* PEACEFUL PURPOSES, *supra* note 90, at 90, 91; *and* Ivan A. Vlastic, *The Legal Aspects of Peaceful and Non-Peaceful Uses of Outer Space*, *in* PEACEFUL AND NON-PEACEFUL USES OF SPACE 37, 42 n. 13 (B. Jasani ed., 1991) (citing A. Chayes, et al., *Space Weapons: the Legal Context*, *in* WEAPONS IN SPACE, No. 7, at 193-97) [hereinafter PEACEFUL USES OF SPACE]; *see also* Jasentuliyana, *supra* note 144, *in* PEACEFUL PURPOSES, at 126 (“[A]ny object carrying [nuclear] weapons in sub-orbital flights such as ICBMs is not included within the meaning of paragraph 1 since the phrase ‘place in orbit’ means that an object would have to complete a full orbit around the Earth in order to be covered by the Treaty.”).

<sup>146</sup> Jasentuliyana, *supra* note 144, *in* PEACEFUL PURPOSES, at 126.

<sup>147</sup> *Cf. id.* (discussing drafting history of Article IV, paragraph 1, which suggests that the exclusion of the Moon from the provision was intentional); *and* Vlastic, *supra* note 134, *in* PERSPECTIVES ON INT’L L., at 397 (referring to the omission of the Moon from Article IV as an “oversight”); *also* CHRISTOL, *supra* note 141, at 20 (“[I]n most instances the inconsistent and non-uniform use of ‘outer-space,’ ‘the moon,’ and ‘other celestial bodies’ can be laid to time constraints and other exigencies surrounding the drafting process.”). The view of U.S. Ambassador to the United Nations, Arthur Goldberg, was that the prohibition in Article IV, paragraph 1, extended to “the Moon or any other celestial body.” CHRISTOL, *supra*, at 21.

<sup>148</sup> *See* Jasentuliyana, *supra* note 144, *in* PEACEFUL PURPOSES, at 127 (“It is [likewise] not clear from its language whether paragraph 1 applies to trajectories to and orbits around celestial bodies.”); *but see* Vlastic, *supra* note 134, *in* PERSPECTIVES ON INT’L L., at 397 (“[I]t should not be difficult to prove, relying on the overall spirit of the Treaty, that the prohibition on these weapons applies also to the moon and other celestial bodies.”).

peaceful purposes.”<sup>149</sup> Here again, by exclusion, this restriction does not apply to the whole of “outer space, the moon, and other celestial bodies.”<sup>150</sup> In this instance, however, the omission of “outer space” from the second paragraph of Article IV was arguably intentional and designed to permit States to be able to carry out certain space activities for military purposes, such as the use of reconnaissance satellites.<sup>151</sup> This interpretation has strong support, not only because the text of the provision was agreed upon in the face of concerns raised by some delegates during negotiations that outer space would be excluded from its coverage,<sup>152</sup> but also because, at the time the treaty was entered into, it was well known that both the United States and the Soviet Union had already launched satellites into space for military purposes.<sup>153</sup>

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<sup>149</sup> Jasentuliyana, *supra* note 144, in PEACEFUL PURPOSES, at 127.

<sup>150</sup> See *id.*; see also CHENG, *supra* note 144, in STUDIES IN SPACE LAW, at 651 (“The only provision in the 1967 Treaty which limits the use of any part of outer space to ‘exclusively... peaceful purposes’ is to be found in the second paragraph of Article IV, but, in very explicit terms, it applies only to ‘the moon and other celestial bodies.’”); Vlasic in PEACEFUL USES OF SPACE, *supra* note 145, at 42 (“[T]he ‘peaceful purposes’ clause applies to the moon and other celestial bodies but not to ‘outer space.’”); J.E.S. FAWCETT, OUTER SPACE: NEW CHALLENGES TO LAW AND POLICY 15 (Clarendon Press 1984) (“[T]here is no provision that outer space shall be used exclusively for peaceful purposes.”); CHRISTOL, *supra* note 141, at 25 (Art. IV, para. 2, does not require use of outer space “per se” for exclusively peaceful purposes); SPACE ACTIVITIES & INT’L LAW, *supra* note 112, at 291 (“[Only] the moon and other celestial bodies were made subject to greater restrictions on military activity pursuant to article IV, paragraph 2.”); Raju in PEACEFUL PURPOSES, *supra* note 90, at 91 (“Under the second paragraph of Article IV, the states parties to the 1967 treaty are under an obligation to use the Moon and other celestial bodies exclusively for peaceful purposes.”); and ZHUKOV, *supra* note 140, at 92-93 (the 1967 Treaty does not provide for “the total demilitarization of outer space” as “just the Moon and other celestial bodies” are required “to be used for peaceful purposes *exclusively*”). Notably, the United States has extended application of the “peaceful purposes” requirement to all of outer space via statute. See 42 U.S.C. § 2451(a) (“[I]t is the policy of the United States that activities *in space* should be devoted to peaceful purposes for the benefit of all mankind.”) (emphasis added).

<sup>151</sup> See CHRISTOL, *supra* note 141, at 24-25; and Raju in PEACEFUL PURPOSES, *supra* note 90, at 91.

<sup>152</sup> See CHRISTOL, *supra* note 141, at 24; Jasentuliyana, *supra* note 144, in PEACEFUL PURPOSES, at 127; and Raju in PEACEFUL PURPOSES, *supra* note 90, at 92.

<sup>153</sup> CHRISTOL, *supra* note 141, at 24. Before 1961, “[w]ith the exception of the highly classified CIA involvement, the existence of a US satellite reconnaissance program had been openly admitted in Congress.” STARES, *supra* note 5, at 62. The Soviet Union, on the other hand, “used to controlling the media—at least at home—and distorting facts, simply denied that it ever engaged in such internationally ‘illegal’ activity as spying on anyone, especially from outer space, even though it was obviously indulging in it.” CHENG, *supra* note 144, in STUDIES IN SPACE LAW, at 650. “[Nevertheless] statements of the significance of military space activities in Soviet planning... emerged on a number of occasions.” STARES, *supra* note 5, at 148-49.



While the foregoing theory reflects the view most widely held among States and scholars,<sup>154</sup> there is a second school of thought that takes a broader approach to interpretation of the Outer Space Treaty. “[L]ooking at other pertinent clauses [e.g., the Outer Space Treaty’s Preamble and the language of Articles IX and XI], referenced U.N. General Assembly resolutions, the U.N. Charter, and international law,” this latter theory “concludes that all ‘outer space’ must be used for peaceful purposes.”<sup>155</sup> Under this broad, contextual interpretation, the general maxims found in the U.N. Charter, the Outer Space Treaty, and elsewhere in international law, such as “‘common interest of all mankind,’ the ‘benefit of all peoples,’ ‘furthering the purposes of the U.N.,’ ‘use in accordance with international law,’ ‘maintaining international peace and security,’ promoting international cooperation’ and ‘having regard for the interests of other States,’” also “define the meaning and applicability of the phrase ‘peaceful purposes.’”<sup>156</sup>

Of course, under the more restrictive interpretation of the Outer Space Treaty, the meaning of “peaceful purposes” in Article IV, paragraph 2, is less significant, since interpreted strictly, the provision simply does not apply to outer space. Moreover, dating back to the time the treaty was adopted, military activities had never been carried out on the Moon and one of the only practical aspects of using a celestial body for military purposes, i.e., the testing of nuclear weapons, was already prohibited by the 1963 Limited-Test-Ban Treaty.<sup>157</sup> However, the adjective “peaceful” in relation to outer space activities is encountered in virtually every U.N. document devoted to outer space matters as well as in space law treaties, including the 1998 IGA for the International Space Station, which, in 2001, became the latest such treaty to enter into force.<sup>158</sup> Once again, the 1998 IGA states that the ISS shall be utilized “for peaceful purposes, in accordance with international law;”<sup>159</sup> thus,

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<sup>154</sup> Richard A. Morgan, *Military Use of Commercial Communication Satellites: A New Look at the Outer Space Treaty and “Peaceful Purposes,”* 60 J. AIR L. & COM. 237, 300 (1994); see also sources cited *supra* note 150.

<sup>155</sup> Morgan, *supra* note 154, at 299; accord. J.N. SINGH, OUTER SPACE, OUTER SEA, OUTER LAND AND INTERNATIONAL LAW 85-86 (Harnam Publ’ns 1987) (“Outer space, minus celestial bodies, by no justification, can legally be used for purposes other than peaceful... The obligation to explore and use outer space for peaceful purposes exists even independent of the provisions of the Outer Space Treaty.”). For a breakdown of U.N. General Assembly Resolutions, Charter provisions, and other sources of international law, including the portions of the Outer Space Treaty Preamble and other articles of the treaty that support this interpretation, see Morgan, *supra* note 154, at 301-302 nn.338-40.

<sup>156</sup> Morgan, *supra* note 154, at 302 (footnotes omitted); see SINGH, *supra* note 155, at 80-88; see also Marko G. Markoff, *Disarmament and “Peaceful Purposes” Provisions in the 1967 Outer Space Treaty*, 4 J. SPACE L. 3, 10-11 (1976) (suggesting that the principle of non-military use of space could arguably be advanced as part and parcel of the “common interest” principle), cited in Morgan, *supra*, at 302 n.341.

<sup>157</sup> Markoff, *supra* note 156, at 5.

<sup>158</sup> Vlasic in PEACEFUL USES OF SPACE, *supra* note 145, at 37-38.

<sup>159</sup> 1998 IGA, *supra* note 20, art. 1, para. 1.

the meaning of the phrase “peaceful purposes” is directly relevant to ISS activities. This subject is addressed in subpart IV.A, *infra*.<sup>160</sup>

### 5. Articles IX, X, and XI

Resolving international problems through international cooperation constitutes one of the primary objectives of the United Nations.<sup>161</sup> In fact, the Declaration on Principles of International Law Concerning Friendly Relations and Cooperation Among Member States in Accordance with the U.N. Charter (Resolution 2625), was unanimously confirmed by all U.N. member States and proclaims cooperation between States to be an international legal obligation.<sup>162</sup> While the “obligation of cooperation” set down in Resolution 2625 pertains exclusively to the U.N. Charter, the principle of international cooperation between States is also made fully applicable to outer space activities by the Outer Space Treaty.<sup>163</sup>

Provisions of the treaty that expressly promote the principle of international cooperation in the exploration and use of outer space include Article IX, emphasizing that States are to be guided by the principle of cooperation and mutual assistance in conducting outer space activities; Article X, requiring States launching objects into space to consider, on the basis of equality, requests by other States to observe the flight of such space objects; and Article XI, requiring that States notify the Secretary-General of the United Nations, and the international community generally, of the nature, conduct, locations, and results of their space activities.<sup>164</sup> These provisions have led to the establishment of official and unofficial tracking stations in almost all States, which together make up a global network of data registration that is available for use by all States and institutions that wish to utilize such observational data.<sup>165</sup>

### 6. Article XII

To help ensure that the demilitarization provisions in Article IV are observed, Article XII of the Outer Space Treaty provides:

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<sup>160</sup> See text accompanying notes 209-236.

<sup>161</sup> U.N. CHARTER, art. 1, para. 3.

<sup>162</sup> Declaration on Principles of International Law Concerning Friendly Relations and Cooperation Among Member States in Accordance with the U.N. Charter, G.A. Res. 2625, U.N. GAOR, 25th Sess., Supp. No. 28, at 121, U.N. Doc. A/5217 (1970).

<sup>163</sup> SPACE ACTIVITIES & INT’L LAW, *supra* note 112, at 348-49 (citing Outer Space Treaty, *supra* note 21, art. I).

<sup>164</sup> *Id.* at 350-51.

<sup>165</sup> REIJNEN, *supra* note 103, at 134.

All stations, installations, equipment and space vehicles on the moon and other celestial bodies shall be open to representatives of other State Parties to the Treaty on the basis of reciprocity. Such representatives shall give reasonable advance notice of a projected visit, in order that appropriate consultations may be held and that maximum precautions may be taken to assure safety and to avoid interference with normal operations in the facility to be visited.

Although the term “reciprocity” perhaps suggests “an interchange of privileges,” such an interpretation must be rejected, since it would mean that a State could then legitimately refuse visits simply by making known its intention not to avail itself of this provision, and, thereby, nullify the legal obligation to allow free access.<sup>166</sup> Rather, “reciprocity” in this instance refers to the right of a State to refuse access to its installations to any State that does not comply with its obligation to allow visits to its installations.<sup>167</sup> In fact, the drafting history of Article XII reveals that the agreement that led to inclusion of the phrase “on the basis of reciprocity” was expressly conditioned on this latter interpretation being universally accepted.<sup>168</sup> As in the case of Article IV, paragraph 2, the “right to inspect” stations, installations, equipment and space vehicles under Article XII of the Outer Space Treaty applies only to the moon and other celestial bodies, and not to outer space.<sup>169</sup>

### 7. Article XIII

Finally, as the last substantive provision of the Outer Space Treaty, Article XIII makes clear that the treaty applies to all activities of State Parties

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<sup>166</sup> BIN CHENG, *The 1967 Outer Space Treaty*, 95 JOURNAL DU DROIT INTERNATIONAL 532 (1968), reprinted in STUDIES IN SPACE LAW, *supra* note 88, at 215, 249; see also REIJNEN, *supra* note 103, at 139.

<sup>167</sup> CHENG, *supra* note 166, in STUDIES IN SPACE LAW, at 249. Such a right is implicit under principles of international law. See RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 335 (1986) (this section follows Article 60(1) and (2) of the Vienna Convention on the Law of Treaties, May 23, 1969, 1155 U.N.T.S. 331 (entered into force Jan. 27, 1980; the United States is not a party to the treaty)).

<sup>168</sup> “The United States... [sought] to preserve the effective operation of the free access clause... [and thus] made it clear... that neither [the advance notice] requirement or the condition of reciprocity implied any ‘veto right.’” CHENG, *supra* note 166, in STUDIES IN SPACE LAW, at 249-50.

<sup>169</sup> *Id.* at 250; see also Harminderpal Singh Rana, *The “Common Heritage of Mankind” & the Final Frontier: A Revaluation of Values Constituting the International Legal Regime for Outer Space Activities*, 26 RUTGERS L. J. 225, 245 (1994) (noting that “[t]he visits and assistance contemplated in [Article XII] are probably intended to be *informational*, rather than use oriented” (emphasis added)); compare Heidi Keefe, *Making the Final Frontier Feasible: A Critical Look at the Current Body of Outer Space Law*, 11 COMPUTER & HIGH TECH. L. J. 345, 352 n.47 (1995) (arguing that the same “reciprocity requirement” that applies on the moon and other celestial bodies theoretically ought apply to outer space as well).

in the exploration and use of outer space, whether carried out individually or, as in the case of the International Space Station, jointly with other States.

## 8. *Other Articles*

Certain Outer Space Treaty articles have been incorporated and expanded upon in successive treaties governing space activities, and are, accordingly, more significant than others. Such articles include: Article V, subsequently reflected in the 1968 Rescue Agreement; the “responsibility and liability clauses” of Articles VI and VII, later reflected in the 1972 Liability Convention; and Article VIII, reflected in the 1976 Registration Convention. These key Outer Space Treaty provisions are discussed below within the context of the treaties that they engendered.

### C. Rescue Agreement (1968)

Article V of the Outer Space Treaty (OST) bestows on astronauts a unique status as “envoys of mankind”<sup>170</sup>—a lofty expression which to some suggests that astronauts enjoy a special immunity from some forms of normal jurisdiction.<sup>171</sup> The basic principles laid down in OST Article V provide for: “(1) assistance to astronauts in the event of accident, distress, or emergency landing; (2) their safe and prompt return; and (3) mutual assistance between astronauts of different States in outer space and on celestial bodies.”<sup>172</sup> The 1968 Rescue Agreement was set up to develop and give further expression to the duties encompassed in OST Article V.<sup>173</sup>

The agreement is essentially a one-sided undertaking by the Contracting Parties to notify the “launching authority” (i.e., “the State responsible for launching”),<sup>174</sup> and the Secretary-General of the United Nations in the event that an astronaut or spacecraft returning from outer space

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<sup>170</sup> Outer Space Treaty, *supra* note 21, art. V, para. 1.

<sup>171</sup> REIJNEN, *supra* note 103, at 107; *but see* CHENG in STUDIES IN SPACE LAW, *supra* note 88, at 417 (noting that during negotiations of the Outer Space Treaty, the representative from Hungary put forward the view that “as ‘envoys’ astronauts should enjoy jurisdictional immunity”; the Soviet representative indicated that, to the contrary, the expression “envoys of mankind” merely “served to justify the legal obligations” in the rest of the article and had “no special legal significance”).

<sup>172</sup> LACHS, *supra* note 134, at 79.

<sup>173</sup> REIJNEN, *supra* note 103, at 157.

<sup>174</sup> Rescue Agreement, *supra* note 68, art. 6. “[W]here an international inter-governmental organization is responsible for launching, [the term ‘launching authority’ shall refer to] that organization, *provided* that that organization declares its acceptance of the rights and obligations provided for in [the Rescue] Agreement and a majority of the States members of that organization are Contracting Parties to [the] Agreement and to the [Outer Space Treaty]” *Id.* (emphasis added); *see also* Outer Space Treaty, *supra* note 21, art. VI (“[States] bear international responsibility for national activities in out space”).

lands within their territory.<sup>175</sup> Contracting Parties further assume an *affirmative duty* to search for, rescue, and unconditionally return the astronaut to representatives of the launching authority; and to do so at no expense to the launching authority.<sup>176</sup> In contrast, the duty to recover downed spacecraft is contingent upon a request from the launching authority, and, even then, the State in which the craft has landed has the option of either returning the object or simply holding it “at the disposal of representatives of the launching authority.”<sup>177</sup> Moreover, unlike the case with the recovery and return of astronauts, expenses incurred by the landing State in the recovery and return of space objects are to be borne by the launching authority.<sup>178</sup>

#### D. Liability Convention (1972)

Articles VI, VII, and IX of the Outer Space Treaty (OST) are linked by their treatment of responsibility for outer space activities.<sup>179</sup> OST Article VI represents the first step in the regulation of responsibility in the space environment.<sup>180</sup> Pursuant to its provisions, States bear international responsibility for any activity in outer space, irrespective of whether such activity is carried out by governmental or non-governmental entities. This principle serves to remove the question of imputability and, thereby, helps to ensure that all activities in outer space are carried out in accordance with the relevant rules of international law.<sup>181</sup> Article VII focuses on liability for damage caused by space objects.<sup>182</sup> Under Article VII, each State from whose

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<sup>175</sup> Rescue Agreement, *supra* note 68, art. 1 and art. 5, para. 1.

<sup>176</sup> *Id.*, art. 2; see CHENG in STUDIES IN SPACE LAW, *supra* note 88, at 419 (“[T]he launching authority... apparently is not responsible for the expenses incurred by other contracting States in rescuing and returning astronauts.”).

<sup>177</sup> Rescue Agreement, *supra* note 68, art. 5, paras. 2 and 3.

<sup>178</sup> *Id.* art. 5, para. 5.

<sup>179</sup> CHRISTOL, *supra* note 141, at 89.

<sup>180</sup> LACHS, *supra* note 134, at 121.

<sup>181</sup> *Id.*

<sup>182</sup> See CHENG, *supra* note 127, in STUDIES IN SPACE LAW, at 603-4 (“Liability represents merely one aspect of responsibility”); see also Bin Cheng, *Article VI of the 1967 Space Treaty Revisited: “International Responsibility,” “National Activities,” and “the Appropriate State,”* 26 J. SPACE L. 7, 9 (1998).

Responsibility means answerability, answerability for one’s acts and omissions, for their being in conformity with whichever system of norms... may be applicable.... Responsibility... [does] not necessarily involve payment of compensation, especially when no damage has been caused, [but, rather, can take the form of] for example assurances of nonrepetition. The term liability is used to specifically denote the obligation to bear the consequences of a breach of legal duty, in particular the obligation to make reparation for any damaged caused.... [R]esponsibility is a broader concept than liability.

territory or facility a space object is launched, as well as each State that actually launches or procures the launching of an object into space, is internationally liable for damage caused by the object, whether such damage occurs on Earth, in outer space, or on the moon or other celestial body. Finally, under OST Article IX, contracting States are obliged to avoid any space activity that would cause harmful contamination or adverse changes to the Earth's environment, and to consult with other States before taking any action that could potentially interfere with their peaceful use of outer space, the Moon, or other celestial bodies.

The Liability Convention specifies the conditions under which liability is to be assessed and compensation paid for damage caused by space objects and formalizes a process whereby claims may be considered and determined.<sup>183</sup> Under the Convention's terms, liability rests with the "launching State" which, though sometimes used interchangeably with "launching authority,"<sup>184</sup> is defined more comprehensively by the treaty to mean: (1) a State which launches or procures the launching of a space object; or (2) a State from whose territory or facility a space object is launched.<sup>185</sup>

Notably, there are no territorial or geographic limits on the application of the Liability Convention, and under Article II of the agreement, the launching state is absolutely liable for "damage caused by its space objects on the surface of the Earth or to aircraft in flight."<sup>186</sup> Elsewhere than on the surface of the Earth, however, liability for damage caused by space objects is based on fault.<sup>187</sup>

The 1998 IGA contains a cross-waiver of liability<sup>188</sup> requiring that ISS Partner States waive all claims against other Partner States, their related entities, or employees of other Partner States or their related entities, for damage arising out of "Protected Space Operations."<sup>189</sup> Nevertheless, the Liability Convention still applies to ISS activities in those situations not specifically covered by the cross-waiver.<sup>190</sup> Accordingly, in the case of a cooperative launch of an ISS element,<sup>191</sup> the Liability Convention subjects each of the States concerned to joint and several liability for any damage that

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*Id.*

<sup>183</sup> CHRISTOL, *supra* note 141, at 91.

<sup>184</sup> See e.g., Edward G. Lee, *Liability for Damage Caused by Space Debris: The Cosmos 954 Claim*, in 26 THE CANADIAN YEARBOOK OF INTERNATIONAL LAW 273, 278 (C.B. Bourne ed., 1988) (discussing the relationship between Article V of the Rescue Agreement and the Liability Convention).

<sup>185</sup> Liability Convention, *supra* note 69, art. I.

<sup>186</sup> *Id.* art. III.

<sup>187</sup> *Id.*

<sup>188</sup> 1998 IGA, *supra* note 20, art. 16.

<sup>189</sup> *Id.* art. 16.3(a).

<sup>190</sup> *Id.* art. 17, para. 1. The ISS cross-waiver of liability only applies to claims for damage arising out of "Protected Space Operations," as defined in Article 16.2(f). See also Moenter, *supra* note 24, at 1047-48 (describing the cross waiver of liability of the 1998 IGA).

<sup>191</sup> See 1998 IGA, *supra* note 20, art. 12(2).

might result from the launching of that Space Station element into outer space.<sup>192</sup>

### **E. Registration Convention (1975)**

The earliest reference to registration of an object launched into space is in Article VIII of the Outer Space Treaty (OST). OST Article VIII provides that a State on whose national registry a “space object” is carried retains “jurisdiction and control over such object and over any personnel thereof, while in outer space or on a celestial body,”<sup>193</sup> establishing registration as the basis for determining the nationality of a space object.

The requirement that each spacecraft have a nationality was generally based on the maritime concept that “when a state gives to a ship the right to use its flag, such state assumes certain international responsibilities for the good conduct of that ship... and at the same time acts as the protector of the ship to enforce its international rights.”<sup>194</sup> The Registration Convention compels States to acknowledge their responsibility for space objects by requiring that any State launching an object into orbit or beyond, register the object in a registry maintained by the “launching State.”<sup>195</sup> The launching State is also obliged to furnish certain information about each space object to the Secretary-General of the United Nations for recording in a central registry of objects launched into outer space.

Here again, “launching State” is defined as: (1) a State which launches or procures the launching of a space object; or (2) a State from whose territory or facility a space object is launched.<sup>196</sup> There is, however, no explicit link between the Registration Convention and the Liability Convention despite the fact that they both have the same definition of launching State.

The Registration Convention entered into force in 1976 and today has more than 50 signatories presumably committed to the principle of registering space objects with the United Nations. Nevertheless, states often delay registering objects launched into space or fail to register them altogether.<sup>197</sup>

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<sup>192</sup> Liability Convention, *supra* note 69, art. V; *see also* 1998 IGA, *supra* note 20, art. 17.3 (Partners may conclude separate agreements regarding the apportionment of any joint and several liability arising out of the Liability Convention).

<sup>193</sup> “The term ‘space object’ includes component parts of a space object as well as its launch vehicle and parts thereof.” Registration Convention, *supra* note 64, art. I. For purposes of international law, “space object” can be defined as “an object designed and intended to penetrate into outer space.” *See supra* text accompanying notes 122-31.

<sup>194</sup> MYERS S. MCDUGAL, ET AL., LAW AND THE PUBLIC ORDER IN OUTER SPACE 585-86 (Yale Univ. Press 1963).

<sup>195</sup> Registration Convention, *supra* note 64, art. II, para. 1.

<sup>196</sup> *Id.* art. I.

<sup>197</sup> Moenter, *supra* note 24, at 1044.

## F. Moon Treaty (1979)

Aside from being dubbed “the last of the ‘first generation’ of space treaties,”<sup>198</sup> the Moon Treaty also holds the distinction of being the first treaty to give effect in international law to the concept of “the common heritage of mankind.”<sup>199</sup> As such, it represents an effort to establish the Moon and other celestial bodies as a new type of territory under international law; *i.e.*, “the common heritage of mankind,” in which national appropriation in a territorial sense is prohibited (*res extra commercium*), and the fruits and resources of the territory are the property of mankind at large.<sup>200</sup> In this regard, however, the Moon Treaty “adds little, if anything, to the provisions of the Outer Space Treaty relating to military space activities.”<sup>201</sup> Furthermore, although in force, the Moon Treaty has been adopted and ratified by only a handful of States, none of which is a significant space power. Therefore, the treaty is of relatively little consequence in establishing international space law.<sup>202</sup>

## G. Summary

In the end, perhaps the most that can be said for certain is that the “*corpus juris spatialis*” partially demilitarizes outer space by (1) banning the use of nuclear weapons anywhere in outer space;<sup>203</sup> (2) prohibiting the

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<sup>198</sup> Reynolds, *supra* note 79, at 115.

<sup>199</sup> BIN CHENG, *The Moon Treaty; Agreement Governing the Activities of States on the Moon and Other Celestial Bodies within the Solar System other than Earth*, 33 CLP 213 (1980), reprinted in *STUDIES IN SPACE LAW*, *supra* note 88, at 357. According to Cheng, the Moon Treaty is also perhaps the most poorly drafted of the five treaties that have emanated from COPUOS. *Id.* at 374.

<sup>200</sup> *Id.* at 357 (noting that, heretofore, international law divided the world into three parts: “(i) national territory, (ii) *res nullis*, *i.e.*, areas which may be acquired as national territory, and (iii) *res extra commercium*, *i.e.*, areas which by law are not susceptible to national appropriation); compare CHRISTOL, *supra* note 141, at 318-19 (“[T]he [Moon] Treaty allows for exploitation by both public and private legal persons of natural resources that have been reduced to possession by the act of removing them from their original in place location. Once such materials and resources are no longer in place the possessor may maintain proprietary rights.”). For discussion of the provisions in the Moon Treaty that together define the territorial status labeled “the common heritage of mankind,” see CHENG, *supra* note 199, at 367-74.

<sup>201</sup> Vlasic in *PEACEFUL USES OF SPACE*, *supra* note 145, at 43; *cf.* Vlasic, *supra* note 134, in *PERSPECTIVES ON INT’L L.*, *supra* note 95, at 397 (noting that the Moon Treaty (art. 1 and 3) corrects an omission in OST Article IV(1), by expressly prohibiting the stationing of weapons of mass destruction in orbits around the Moon and other celestial bodies or trajectories to or around them); and see generally BIN CHENG, *Definitional Issues in Space Law: the “Peaceful Use” of Outer Space, including the Moon and other Celestial Bodies* (Adapted from the paper *The Status of Outer Space and Relevant Issues: Delimitation of Outer Space and Definitions of “Peaceful Use,”* 11 J. SPACE L. 89 (1983)), in *STUDIES IN SPACE LAW*, *supra* note 88, at 513, 532-34 (discussing the provisions of the Moon Treaty related to the military use of space).

<sup>202</sup> See generally *supra* note 79 and 201.

<sup>203</sup> Limited-Test-Ban Treaty, *supra* note 74, art. I.



stationing weapons of mass destruction in orbit around the earth, moon or any other celestial body, or otherwise installing such weapons on the moon or any other celestial body;<sup>204</sup> (3) restricting use of the moon and other celestial bodies for “exclusively peaceful purposes;”<sup>205</sup> and (4) expressly forbidding military maneuvers, the testing of weapons, or the establishment of military bases, installations or fortifications on celestial bodies.<sup>206</sup> However, while outer space plainly remains open to military use,<sup>207</sup> the 1998 IGA itself expressly restricts use of the ISS to “peaceful purposes.”<sup>208</sup> Therefore, the question that remains is, What are the legal obligations of the ISS Partners concerning use of Space Station Alpha for “peaceful purposes”?

#### IV. ‘PEACEFUL PURPOSES’ AND THE ISS

##### A. Meaning of ‘Peaceful Purposes’

While the adjective “peaceful” can be found in virtually all U.N. documents relating to outer space, the treaties which comprise international space law fail to provide an authoritative definition of that term.<sup>209</sup> The phrase “peaceful purposes” as used in the 1967 Outer Space Treaty (OST) was originally adapted from the 1959 Antarctic Treaty (AT),<sup>210</sup> which, to a considerable extent, served as the model for the 1967 treaty.<sup>211</sup> Article I of the AT reads as follows:

1. Antarctica shall be used for peaceful purposes only. There shall be prohibited, *inter alia*, any measures of a military nature, such as the establishment of military bases and fortifications, the carrying out of military maneuvers, as well as the testing of any type of weapons.
2. The present Treaty shall not prevent the use of military personnel or equipment for scientific research or for any other purpose.

Because the AT is credited with the “demilitarization” of the Antarctic,<sup>212</sup> it is often cited as the most authoritative aid for the interpretation

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<sup>204</sup> Outer Space Treaty, *supra* note 21, art IV, para. 1.

<sup>205</sup> *Id.* art IV, para. 2.

<sup>206</sup> *Id.* For a comprehensive summary of military activities prohibited and permitted by treaty or customary international law, see Vlasic in PEACEFUL USES OF SPACE, *supra* note 145, at 47-50.

<sup>207</sup> Outer Space Treaty, *supra* note 21, art IV, para. 2; see also sources cited *supra* note 150.

<sup>208</sup> 1998 IGA, *supra* note 20, art. 1, para. 1.

<sup>209</sup> Vlasic in PEACEFUL USES OF SPACE, *supra* note 145, at 37; see also Bhupendra Jasani, *Introduction to PEACEFUL USES OF SPACE*, *supra* note 145, at 1, 7.

<sup>210</sup> Antarctic Treaty, Dec. 1, 1959, 12 U.S.T. 794, 402 U.N.T.S. 72, 1959 U.S.T. LEXIS 420 (ratified by the United States on Aug. 18, 1960; entered into force on Jun. 23, 1961).

<sup>211</sup> REIJNEN, *supra* note 103, at 88.

<sup>212</sup> See Vlasic in PEACEFUL USES OF SPACE, *supra* note 145, at 41 n.12; see also Aldo A. Cocca, *Historical Precedents for Demilitarization*, in PEACEFUL PURPOSES, *supra* note 90, at 29, 41-42.

of the term “peaceful” in the outer space context,<sup>213</sup> particularly by those who seek to equate “peaceful,” as it pertains to outer space, with “non-military.”<sup>214</sup> However, in view of the fact that the OST permits certain military activities in those areas expressly reserved “exclusively for peaceful purposes” (i.e., the moon and other celestial bodies),<sup>215</sup> and, at the same time, makes international law (including the right of self-defense) applicable to those same extraterrestrial regions,<sup>216</sup> it is doubtful that the drafters of the treaty intended to attach such a definition to the term “peaceful.”<sup>217</sup> Furthermore, the practice of States at the time of the treaty’s adoption and since plainly belies such an interpretation.<sup>218</sup>

From the very early space age up to the present, the official position of the United States has been that “peaceful” means “non-aggressive” and not “non-military.”<sup>219</sup> Indeed, while some of the initial U.S. statements on the international control of space activities appear to support the proposition that outer space should be used exclusively for *nonmilitary* purposes,<sup>220</sup> by the spring of 1958 (less than a year after the launch of Sputnik I), anticipation of the availability of reconnaissance satellites caused a decisive shift in U.S. policy towards the view that space could and should be used for “peaceful,”

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<sup>213</sup> Vlasic in PEACEFUL USES OF SPACE, *supra* note 145, at 41.

<sup>214</sup> See CHENG, *supra* note 144, in STUDIES IN SPACE LAW, at 650-51.

<sup>215</sup> Outer Space Treaty, *supra* note 21, art. IV, para. 2.

<sup>216</sup> *Id.* art. III; see also *supra* text accompanying notes 129-35.

<sup>217</sup> See Jasentuliyana, *supra* note 144, in PEACEFUL PURPOSES, at 128; and Stephen Gorove, Article IV of the Outer Space Treaty and Some Alternatives for Further Arms Control, in PEACEFUL PURPOSES, *supra* note 90, at 77, 82 (asserting that the drafters intended to give “peaceful” a distinct meaning within the context of the treaty itself); cf. CHENG, *supra* note 144, in STUDIES IN SPACE LAW, at 650 (arguing that Article I of the Antarctic Treaty, in which the word “peaceful” is used in contradistinction to “military,” was “very much on the minds of those who drew up the 1967 Space Treaty”). In this regard, the argument that the Outer Space Treaty prohibits all military activities on the Moon and other celestial bodies, *except* those expressly permitted by the treaty (see e.g., LACHS, *supra* note 134, at 106-08), would appear to gain support from the fact that at the time the treaty was adopted, military activities were not being carried out in these areas.

<sup>218</sup> See Vlasic in PEACEFUL USES OF SPACE, *supra* note 145, at 42, 45. Vlasic notes that at the time negotiations on the Outer Space Treaty began, the United States and Soviet Union were both already “using outer space for a variety of military purposes” (e.g., surveillance, communications, navigation, etc.), which the United States openly regarded as “peaceful.” While the Soviet Union publicly opposed these activities, it secretly engaged in them as well, and thus acquiesced to the U.S. interpretation.”

<sup>219</sup> CHENG, *supra* note 201, in STUDIES IN SPACE LAW, at 515; see also Morgan, *supra* note 154, at 304 nn.353-55.

<sup>220</sup> E.g., National Security Council Action No. 1553 (Nov. 21, 1956) (outlining a U.S. disarmament proposal to prohibit “the production of objects designed for travel in or projection though outer space for military purposes,” which would have ultimately banned ICBMs as well as military satellites), *quoted in* STARES, *supra* note 5, at 54 (“It is difficult to assess how sincere Eisenhower and his administration were with these proposals.”); see also Vlasic in PEACEFUL USES OF SPACE, *supra* note 145, at 39.

rather than “nonmilitary” purposes.<sup>221</sup> Thus, the National Aeronautics and Space Act of 1958 (Space Act) (the statutory basis for the national space program)<sup>222</sup> requires that U.S. space activities be devoted to “peaceful purposes” while also providing that these activities shall contribute to “national defense.”<sup>223</sup>

The U.S. interpretation of “peaceful” as synonymous with “non-aggressive” was a logical extension of America’s effort to gain international legal recognition of the permissibility of reconnaissance satellites, while simultaneously discouraging military space activities that threatened these assets—two major goals of U.S. space policy during the pre-Outer Space Treaty era (1957-1967).<sup>224</sup> The definition is a corollary to the meaning of the terms “peace” and “aggression” found in the U.N. Charter.<sup>225</sup> “Essentially, nations have agreed in the Charter to act ‘peacefully,’ a term which the Charter then elaborates with specific examples, *e.g.*, suppression of acts of aggression, no threats or use of force, save in the common interest or for (legitimate) self-defense.”<sup>226</sup> By the same token, “‘peaceful purposes’... was interpreted by the United States to mean... [that] all military uses are permitted and lawful as long as they remain ‘nonaggressive’ as per Article 2(4) of the U.N. Charter, which prohibits ‘the threat or use of force.’”<sup>227</sup>

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<sup>221</sup> See NATIONAL SECURITY COUNCIL, PRELIMINARY U.S. POLICY IN OUTER SPACE (NSC 5814/1) (Jun. 20, 1958), reprinted in ORGANIZING FOR EXPLORATION, 1 EXPLORING THE UNKNOWN: SELECTED DOCUMENTS IN THE HISTORY OF THE U.S. CIVIL SPACE PROGRAM (J. Logsdon ed., 1998); quoted in STARES, *supra* note 5, at 55; cf. Vlasic in PEACEFUL USES OF SPACE, *supra* note 145, at 40 (“[A]s early as 1958-59, the legal position of the United States with respect to the meaning of the phrase “peaceful uses” became crystallized along lines quite dissimilar from the initial rhetoric.”).

<sup>222</sup> National Aeronautics and Space Act of 1958, Pub. L. No. 85-568, 72 Stat. 426 (1958) (unamended) (codified as amended at 42 U.S.C. §§ 2451 et seq. (2000)) [hereinafter 1958 Space Act].

<sup>223</sup> *Id.* §102.

<sup>224</sup> See STARES, *supra* note 5, at 59-71; see also SPIRES, *supra* note 5, at 108-12.

<sup>225</sup> Morgan, *supra* note 154, at 305; see U.N. CHARTER, *supra* note 133, art. 1, para. 1, and art. 2, para. 3.

<sup>226</sup> *Id.* at 305 n.357.

<sup>227</sup> Vlasic in PEACEFUL USES OF SPACE, *supra* note 145, at 40; see also Dembling & Arons, *supra* note 98, at 434. Commenting on the prospect of future efforts to address the non-incorporation of outer space into the Outer Space Treaty provision in Article IV(2), which confines all activities on the Moon and other celestial bodies to solely “peaceful purposes,” Dembling, then General Counsel of NASA, writes: “In the interim, one might conclude that any military use of outer space must be restricted to *nonaggressive purposes* in view of Article III, which makes applicable international law including the Charter of the United Nations” (emphasis added). *But cf.* CHENG, *supra* note 144, in STUDIES IN SPACE LAW, at 651-52 (proposing that the U.S. interpretation of “peaceful” as meaning “non-aggressive” is due to “an initial misreading of the Treaty and the erroneous belief that the restriction of the use for ‘exclusively peaceful purposes’... extends to the whole of outer space.”).

In contrast, the Soviet Union (U.S.S.R.), as part of its diplomatic offensive to ban U.S. reconnaissance satellites,<sup>228</sup> initially took the view that “peaceful purposes” meant “non-military,” and, thus, maintained that military activities in outer space were totally prohibited.<sup>229</sup> However, although the Soviets consistently maintained that all of its activities in space were “peaceful” and “scientific,”<sup>230</sup> the U.S.S.R.’s official line eventually softened as its military satellite programs came into their own, such that it can be said that the Soviets, at least, acquiesced to the U.S. interpretation.<sup>231</sup> So, as Professor Vlasic notes:

[w]ith only the Soviet Union and the United States active in outer space before and for sometime after entry into force of the OST, the ‘practice’ of even one space power, clearly a ‘specially affected’ state, carried substantial weight in law. All the more so when supported by several other states with developing space capabilities.<sup>232</sup>

While it can perhaps be argued that there are still two competing definitions of “peaceful purposes” (one being “non-military” and the other “non-aggressive”),<sup>233</sup> no State has ever formally protested the U.S. version of “peaceful” in the context of outer space activities;<sup>234</sup> a consensus has developed within the United Nations that “peaceful” more specifically equates to “non-aggressive.”<sup>235</sup> Nevertheless, the scope and substance of the notion of “peaceful use of outer space and celestial bodies” remains one of the main sources of controversy surrounding space activities.<sup>236</sup> Perhaps nowhere is this

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<sup>228</sup> See STARES, *supra* note 5, at 69.

<sup>229</sup> Vlasic in PEACEFUL USES OF SPACE, *supra* note 145, at 40. “For more than twenty years scholars of international law in the Soviet Union have unanimously stated that ‘use for peaceful purposes’ should be interpreted as ‘nonmilitary use.’” *Id.* at n.11.

<sup>230</sup> See Morgan, *supra* note 154, at 304; and CHENG, *supra* note 144, in STUDIES IN SPACE LAW, at 650.

<sup>231</sup> See STARES, *supra* note 5, at 71 (“Soviet diplomatic opposition to U.S. reconnaissance satellites effectively ceased in September 1963.”). See also Vlasic in PEACEFUL USES OF SPACE, *supra* note 145, at 42; and Morgan, *supra* note 154, at 304.

<sup>232</sup> Vlasic in PEACEFUL USES OF SPACE, *supra* note 145, at 45 n.16 (noting that “[a] rule becomes a rule of customary international law when a significant majority of states, including states whose interests are specifically affected, act in accordance with that rule because they believe it to be binding... [and] state practice... [is] both extensive and virtually uniform.” (citing *The North Sea Continental Shelf (F.R.G. v. Den. and Neth.)*, 1969 I.C.J. 3, 46, para. 73 (Feb 20)).

<sup>233</sup> This debate “has not been resolved and may never be.” Morgan, *supra* note 154, at 241; see also CHENG, *supra* note 144, in STUDIES IN SPACE LAW, at 650-52.

<sup>234</sup> Vlasic in PEACEFUL USES OF SPACE, *supra* note 145, at 45.

<sup>235</sup> Morgan, *supra* note 154, at 303 (quoting Reed & Norris, *supra* note 16, at 678). In practice, this has led to an understanding among the major space actors that all military activities in outer space are permissible, unless specifically prohibited by treaty or customary international law. Vlasic in PEACEFUL USES OF SPACE, *supra* note 145, at 38, 45.

<sup>236</sup> Manfred Lachs, *Views from the Bench: Thoughts on Science, Technology and World Law*, 86 A.J.I.L. 673, 686 (1992).

conundrum more clearly exemplified than in the context of the International Space Station (ISS).

### B. ISS as a ‘Civil’ Facility (Permissibility of Military Use)

Under international law, States are free to erect space stations in outer space, even if they are devoted exclusively to military purposes, provided they do not run afoul of the minimal limitations of the Outer Space Treaty (OST) by carrying nuclear weapons or other weapons of mass destruction onboard.<sup>237</sup> Similarly, there is no restriction on the use of military personnel in outer space.<sup>238</sup> In fact, the OST expressly provides that military personnel are even permitted to perform certain “peaceful” activities, such as scientific research, on the Moon and other celestial bodies.<sup>239</sup> While the 1998 Intergovernmental Agreement (IGA) explicitly calls for a “civil international Space Station,” which is to be operated and utilized “for peaceful purposes, in accordance with international law,”<sup>240</sup> what significance this has in terms of its potential use for military purposes is not entirely clear.

Typically, a space system is considered “civil” if it is owned and operated by a non-military government agency, a business or other non-governmental organization, or an international organization of regional or global participation.<sup>241</sup> So, for example, the satellite system of the International Telecommunications Satellite Organization (Intelsat),<sup>242</sup> though daily used by both civil and military customers,<sup>243</sup> is still regarded as a civil system.<sup>244</sup> Another case in point is the system operated by the International

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<sup>237</sup> Outer Space Treaty, *supra* note 21, art. IV; *see also* Vlastic in PEACEFUL USES OF SPACE, *supra* note 145, at 50.

<sup>238</sup> Vlastic in PEACEFUL USES OF SPACE, *supra* note 145, at 50.

<sup>239</sup> Outer Space Treaty, *supra* note 21, art. IV, para. 2. For the full text, *see supra* text accompanying notes 13943-44. The identical language is used in the Moon Treaty, *supra* note 79, art. III, para. 4.

<sup>240</sup> 1998 IGA, *supra* note 20, art. 1, para. 1, and art. 14, para. 1; *see supra* text accompanying note 37.

<sup>241</sup> *See* DOYLE, *supra* note 4, at 85.

<sup>242</sup> Agreement on the International Telecommunications Satellite Organization (Intelsat), Aug. 20, 1971, 23 U.S.T. 3810, 1971 U.S.T. LEXIS 157 (entered into force on Feb. 12 1973) [hereinafter Intelsat Agreement], *reprinted in* 4 U.S. SPACE LAW, *supra* note 25, § II.A.9 (Oct. 1986); Operating Agreement Relating to the International Telecommunications Satellite Organization (Intelsat), Feb. 12 1973, 23 U.S.T. 4091, 1973 U.S.T. LEXIS 302, *reprinted in* 4 U.S. SPACE LAW, *supra* note 25, § II.A.10 (Oct. 1986).

<sup>243</sup> The Intelsat Agreement prohibits use of its space segment to provide “specialized communication services” for military purposes. Intelsat Agreement, *supra* note 242, art. III, paras. (d) and (e). However, the services provided to DOD are considered “public communication services” available to the military forces of any signatory State. Since Intelsat does not provide any “specialized services” (which evidently would require equipping satellites with special hardware) to anyone at this time, military use of the system is not an issue. Morgan, *supra* note 154, at 293-94.

<sup>244</sup> DOYLE, *supra* note 4, at 86.

Maritime Satellite Organization (Inmarsat),<sup>245</sup> a “hybrid” commercial enterprise/public service organization.<sup>246</sup> As with the 1998 IGA, the Inmarsat Convention contained a “peaceful purposes” clause,<sup>247</sup> and yet Inmarsat’s services were used by U.S. and coalition forces during the 1991 Gulf War, and thereafter by U.N. peacekeeping forces in Somalia, Bosnia and Croatia.<sup>248</sup>

Then again, ownership and management are not necessarily determinative of whether a given space system is civil or military; oftentimes it is the use and/or type of user that is controlling.<sup>249</sup> Thus, for example, although the Hughes *Leasat* satellite was commercially owned and managed, it was under contract to the U.S. Navy which controlled its design, development, production, launch, and provision of services. *Leasat*, therefore, could justifiably be deemed to be a military satellite.<sup>250</sup> In any case, as the examples of Intelsat and Inmarsat show, the mere fact that a space system is regarded as “civil” does not preclude the possibility of it being used for military purposes.

With respect to space systems owned and operated by NASA, the United States has long maintained a degree of separation between its military and civilian space activities;<sup>251</sup> however, as was shown previously, the proverbial “firewall between military space and civilian space”<sup>252</sup> has not always been strictly maintained.<sup>253</sup> Accordingly, there is some historical precedent for conducting military-related activities aboard NASA spacecraft. Moreover, the 1958 Space Act not only authorizes space activities in support of U.S. national defense, but also explicitly provides for NASA to make

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<sup>245</sup> Convention on the International Maritime Satellite Organization (Inmarsat), Sept. 3, 1976, 31 U.S.T. 1, 1976 U.S.T. LEXIS 309 (entered into force on Jul. 16, 1979) [hereinafter Inmarsat Convention], *reprinted in* 4 U.S. SPACE LAW, *supra* note 25, § II.A.12 (Oct. 1986); Operating Agreement on the International Maritime Satellite Organization (Inmarsat), Jul. 16, 1979, 31 U.S.T. 135, 1979 U.S.T. LEXIS 309, *reprinted in* 4 U.S. SPACE LAW, *supra* note 25, § II.A.13 (Oct. 1986).

<sup>246</sup> Morgan, *supra* note 154, at 280.

<sup>247</sup> “The Organization shall act exclusively for peaceful purposes.” Inmarsat Convention, *supra* note 245, art. 3(3). *See also* Nick Rowe, Peaceful Purposes (1999) (fact sheet published by the Inmarsat Legal Services Dept.) (on file with author) (“Whilst Inmarsat is now privatized and is no longer subject to the Convention, it is nevertheless obliged under its Public Services Agreement to continue to act exclusively for peaceful purposes.”).

<sup>248</sup> *See* Morgan, *supra* note 154, at 265-70 (discussing military satellite use during regional conflicts).

<sup>249</sup> DOYLE, *supra* note 4, at 91.

<sup>250</sup> *Id.* at 88, 90 (*Leasat* had a design life beyond the time period of the Navy’s needs and, thus, under Hughes’ lease arrangement, Hughes retained the right to recover the satellite after the expiration of the Navy’s lease and revert the balance of its useful life to commercial applications).

<sup>251</sup> For a historical overview of the U.S. policy of segregating military and civilian space activities, *see* Christopher M. Petras, The Convergence of U.S. Military and Commercial Space Activities (2001) (unpublished LL.M. thesis, McGill University) (on file with author).

<sup>252</sup> *See* Hettena, *supra* note 18 (quoting U.S. Senator Mikulski discussing the growing cooperation between the military and NASA).

<sup>253</sup> *See e.g.*, *supra* note 5.

available “to agencies directly concerned with national defense” any information of “military value or significance.”<sup>254</sup> There is thus a specific statutory basis for cooperation between NASA and DOD in national security matters, clearly on display in the military’s use of archived NASA satellite imagery during the Gulf War and, more recently, when U.S. forces used “real-time,” albeit unclassified data from advanced NASA satellites in support operations during the war in Afghanistan.<sup>255</sup>

In the case of the Space Station, notwithstanding the 1998 IGA’s reference to the “civil” nature of the facility, neither the Agreement nor the implementing MOUs specify what restrictions, if any, are imposed on use of the ISS for military purposes by virtue of either the characterization of the ISS as “civil” or the 1998 IGA’s “peaceful purposes” requirement. Notably, the 1987 law authorizing NASA to undertake construction of an international space station provided that the facility was to serve four purposes:

- (1) the conduct of scientific experiments, applications experiments and engineering experiments;
- (2) the servicing, rehabilitation, and construction of satellites and space vehicles;
- (3) the development and demonstration of products and processes; and
- (4) the establishment of a space base for other civilian and commercial space activities.<sup>256</sup>

From the phrase “*for other civilian and commercial space activities*,” one could reasonably infer that all of the enumerated uses of the international space station are to be understood as being civilian and commercial in nature—*i.e.*, “non-military.”<sup>257</sup> If this inference were accepted, it could be construed that use of the U.S. space station elements for any military purpose is contrary to the intended purpose under U.S. law.

The United States, however, does not subscribe to this view, as revealed during the course of negotiations on the ISS Agreement. Specifically,

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<sup>254</sup> 42 U.S.C. § 2451(d)(6).

<sup>255</sup> See Craig Covault, *Navy Enlists NASA In the War on Terror*, AVIATION WK. & SPACE TECH., Apr. 8, 2002, at 30; see also Hettena, *supra* note 18 (According to NASA, the images that the U.S. military used in Afghanistan were “available to ‘anyone and everyone,’ including a host of federal agencies and foreign governments.”).

<sup>256</sup> Act of Oct. 30, 1987, *supra* note 24, § 106. Section 108 of the same law provides for “development of the space station... [as] part of a balanced *civilian* space program.” (emphasis added).

<sup>257</sup> See generally S. Neil Hosenball, *The Space Station—Past, Present and Future with some Thoughts on some legal Questions that need to be addressed*, in *SPACE STATIONS*, *supra* note 10, at 36 (“The Space Station has been fully justified as a *civil and commercial space facility*... No national security related funds will be used [for Space Station development].”) (emphasis added).

in 1988, during talks between the United States and the European Partner States, the Chief U.S. Negotiator professed the view that—

the United States has the right to use its elements, as well as its allocations of resources derived from the Space Station infrastructure, *for national security purposes...* [and further] [w]ith respect to such uses of these elements and resources, the decision whether they may be carried out under the Agreement will be made by the United States.<sup>258</sup>

In response to the American position, the members of the European Governments' Delegation maintained that “with respect to the use of elements of the permanently manned civil Space Station provided by Europe, the European partner will be guided by Article II of the Convention establishing the European Space Agency [ESA],”<sup>259</sup> which provides:

The purpose of the Agency shall be to provide for and to promote, for exclusively peaceful purposes, cooperation among European States in space research and technology and their space applications, with a view to their being used for scientific purposes and for operational space applications systems.<sup>260</sup>

The European delegates further made it clear that by “peaceful purposes” they meant civil, non-military projects;<sup>261</sup> thereby linking the concepts of “peaceful” and “scientific” purposes, while at the same time dispelling any notion that “operational space applications” might include systems used in national defense.

The issue of the “civil” character and “peaceful use” of the Station was again of primary importance during subsequent negotiations on the 1998 IGA, particularly with the European member states.<sup>262</sup> Nevertheless, the prevalence of the United States' 1988 negotiating position appears to be born out by the language that was ultimately incorporated into the 1998 Agreement. Once more, Article 9.3(b) provides:

[T]he Partner providing an element shall determine whether a contemplated use of that element is for peaceful purposes, except that this subparagraph shall not be invoked to prevent any Partner from using resources derived from the Space Station infrastructure.

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<sup>258</sup> CHENG, *supra* note 144, in *STUDIES IN SPACE LAW*, at 653 n.44 (emphasis added).

<sup>259</sup> *Id.*

<sup>260</sup> Belgium-Denmark-France-Federal Republic of Germany-Italy-Netherlands-Spain-Sweden-Switzerland-United Kingdom: Convention for the Establishment of a European Space Agency, May 30, 1975, art. II, 14 I.L.M. 855, 865-66 (1975) (entered into force Oct. 30, 1980) [hereinafter *ESA Convention*].

<sup>261</sup> CHENG, *supra* note 144, in *STUDIES IN SPACE LAW*, at 652.

<sup>262</sup> Moenter, *supra* note 24, at 1045.



If by “peaceful purposes” the Partners had, in fact, meant “civil, non-military purposes” then Article 9.3(b) would seemingly be superfluous. Moreover, the Article 1.1 declaration that the ISS be used for “peaceful purposes, *in accordance with international law*” would be rendered meaningless, since the term “peaceful purposes,” as used in the OST, plainly allows for some military activities.<sup>263</sup> Therefore, such an interpretation presumably cannot be correct.<sup>264</sup> Indeed, the above-mentioned declaration strongly suggests that, notwithstanding the nebulous language of the U.S. authorizing statute or the express characterization of the ISS as a “civil” facility, the term “peaceful purposes” should be given the meaning that it has generally been accorded under the international law governing outer space activities: that “peaceful purposes” does not exclude military activities so long as those activities are conducted as part of an enforcement action authorized by the U.N. Security Council,<sup>265</sup> pursuant to the right to individual or collective self-defense under Article 51 of the U.N Charter, or consistent with the inherent right of self-defense under customary international law.<sup>266</sup>

Even so, the fact that yet another ISS Partner, namely the Russian Federation, has recently made a renewed call for the complete demilitarization of outer space could once again cast the meaning of “peaceful purposes” as it pertains to the ISS into the fray.<sup>267</sup> However, time will tell whether this initiative represents a legitimate shift in Russian military posture or merely a retreat to the same rhetoric long espoused by the former Soviet Union.<sup>268</sup> Indeed, for decades the Soviets maintained the official position that “peaceful” meant totally non-military, while simultaneously engaging in a wide range of military space activities.<sup>269</sup> Furthermore, in the period since the Soviet Union’s collapse, Russia has gone to great lengths to insulate its space program from the problems that have plagued the rest of its economy and has spent staggering amounts on “space defense.”<sup>270</sup> This has led some to suggest that

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<sup>263</sup> See *supra* text accompanying notes 1415-51; and *supra* text accompanying notes 1948-2048.

<sup>264</sup> Cf. CHENG, *supra* note 144, in *STUDIES IN SPACE LAW*, at 651-52.

<sup>265</sup> U.N. CHARTER, *supra* note 133, arts. 25, 39, 42, and 48.

<sup>266</sup> See Schmitt, *supra* note 22, at 1087; see also Morgan, *supra* note 154, at 295 (“‘peaceful purposes’ does not exclude military activities so long as those activities are consistent with the United Nations Charter”).

<sup>267</sup> See Sean R. Mikula, *Blue Helmets in the Next Frontier: The Future is Now*, 29 GA. J. INT’L & COMP. L. 531, 549-50 nn.85-87 (2001) and sources cited (discussing the international conference on preventing an arms race in space that was initiated and hosted by Russian President Vladimir Putin in April 2001).

<sup>268</sup> See e.g., Draft Treaty on the Prohibition of the Stationing of Weapons of Any Kind in Outer Space, U.N. GAOR, 36th Sess., Annex, U.N. Doc. A/36/192 (1981) (presented to the U.N. Secretary-General by the U.S.S.R. Minister for Foreign Affairs on Aug. 10, 1981).

<sup>269</sup> See *supra* notes 153, 218; see also STARES, *supra* note 5, *passim*.

<sup>270</sup> David Tan, *Towards a New Regime for Protection of Outer Space as the “Province of All Mankind,”* 25 YALE J. INT’L L. 145, 167 n.100 (2000), citing Albert Gore, Jr., *Outer Space, the*

Russia's new utopian stance is nothing more than an attempt to freeze the balance of power in the face of increasingly superior U.S. military space capabilities.<sup>271</sup> In any case, given the extensive history of Russian military utilization of outer space under both the Soviet regime and succeeding administrations,<sup>272</sup> the Russian Federation's current musing about the demilitarization of space could reasonably be looked upon with skepticism.

Additionally, even assuming the Partners tacitly agreed that the Space Station's "civil" character precluded any dedicated missions or projects from being carried out aboard the ISS, either directly by or on behalf of their respective armed forces, use of the facility by commercial entities for activities of a military nature would not be foreclosed. As previously mentioned, Article IV of the Outer Space Treaty states: "The use of military personnel for scientific research or for any other peaceful purposes shall not be prohibited."<sup>273</sup> Although this provision pertains to the use of "military personnel" to conduct scientific research on the Moon and other celestial bodies, it has been argued that the additional phrase "*or for any other peaceful purposes*" underscores the fact that the drafters of the Treaty regarded scientific research as a *per se* "peaceful" activity—*i.e.*, "irrespective of whether it is conducted by civilian or military personnel."<sup>274</sup>

From this standpoint, the underlying purpose of the research, whether for advancement of science, military defense, or some other purpose, has no bearing on the lawfulness (or perhaps more specifically, the "peacefulness") of any research activity.<sup>275</sup> Therefore, so long as the experimentation or testing does not itself contravene international law,<sup>276</sup> virtually all types weapons research would be permissible onboard the ISS *provided* the ultimate purpose

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*Global Environment, and International Law: Into the Next Century*, 57 TENN. L. REV. 329, 332 (1990).

<sup>271</sup> See Mikula, *supra* note 267, at 550.

<sup>272</sup> For an in-depth discussion of the history of Soviet military space capabilities, see NICHOLAS L. JOHNSON, *SOVIET MILITARY STRATEGY IN SPACE* (Jane's Publishing Co. 1987); see also Tan, *supra* note 270, at 167 n.100.

<sup>273</sup> Outer Space Treaty, *supra* note 21, art. IV, para. 2.

<sup>274</sup> Gorove, *supra* note 217, in *PEACEFUL PURPOSES*, *supra* note 90, at 82; see also CHENG, *supra* note 199, at 369 ("[T]he 1967 Space Treaty in its Article 1(3) asserts a general freedom of scientific investigation in outer space.").

<sup>275</sup> Gorove, *supra* note 217, in *PEACEFUL PURPOSES*, *supra* note 90, at 82;

<sup>276</sup> *E.g.*, Limited-Test-Ban Treaty, *supra* note 74, forbids State parties from carrying out the explosion of nuclear devices in outer space; see also, *e.g.*, Outer Space Treaty, *supra* note 21, art. IV (bans placement of nuclear weapons or other weapons of mass destruction in earth orbit); and Convention on the Prohibition of Military or Any Other Hostile Use of Environmental Modification Techniques, Dec. 10, 1976, U.N. GAOR, 31st Sess., Supp. No. 39, at 36, U.N. Doc. A/RES/31/72 (1977), 31 U.S.T. 333 (ratified by the United States on Dec. 13, 1979; entered into force on Jan. 17, 1980) (prohibits military or other hostile use of environmental modification techniques—*i.e.*, the deliberate manipulation of natural processes—that are widespread, long lasting, or severe, to include changes to the dynamics, composition or structure of outer space).

of the activity was self-defense—a “peaceful purpose.”<sup>277</sup> Hence, with the onset of Space Station commercialization,<sup>278</sup> it is conceivable that a commercial firm could, consistent with the ISS goal of enhancing the scientific, technological, and commercial use of outer space,<sup>279</sup> use ISS facilities to perform research for the advancement of some military technological objective without contravening the “peaceful purposes” requirement as defined by international law.<sup>280</sup>

### C. Prospects for Limiting Military Activities

Beyond the many ambiguities surrounding the 1998 International Agreement’s (IGA) “peaceful purposes” requirement, one should also not overlook the fact that the Agreement fails to address a number of key issues which have a direct impact on the availability of limitations or controls that ISS Partners could impose on the conduct of military-related activities onboard the Space Station by other Partners, or by commercial firms from other Partner (or even non-Partner) States.

Indeed, it plainly appears as though the 1998 IGA places no restrictions on military use of the ISS whatsoever, aside from those imposed on military space activities generally under international law. Once again, under the Agreement each ISS Partner retains jurisdiction and control over the Space Station elements it provides,<sup>281</sup> and the determination of whether a contemplated use of a Space Station element is for “peaceful purposes, in accordance with international law” is expressly removed from the scope of the ISS “consensus management” regime<sup>282</sup> and placed in the hands of the Partner providing the element concerned.<sup>283</sup> Thus, inasmuch as activities onboard the ISS are governed by the Outer Space Treaty (OST),<sup>284</sup> a Partner is legally obliged to consult with the other ISS Partners before proceeding with military-

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<sup>277</sup> See Morgan, *supra* note 154, at 306 (“[S]tate practice appears to confirm that ‘use’ is to be distinguished from ‘purpose.’ Take, for example, the ‘Star Wars’ program... Although arguably ‘non-peaceful’ or ‘aggressive’ uses might be made of space, the stated purpose of the program was to defend the U.S., a peaceful ‘purpose’ [of] self-defense. Therefore, the drafters very deliberately distinguished between ‘use’ from ‘purpose’ and intentionally chose the latter. As a result, through the use of the term ‘purpose,’ the drafters of the Outer Space Treaty incorporated a ‘rightful intent’ test.”).

<sup>278</sup> See sources cited *supra* note 19.

<sup>279</sup> 1998 IGA, *supra* note 20, art. 1, para. 1.

<sup>280</sup> Cf. Logsdon, *supra* note 19, at 245 (“Among the many unresolved issues [with respect to ISS commercialization] are... the legal issues associated with commercial research aboard the ISS.”).

<sup>281</sup> 1998 IGA, *supra* note 20, art. 5, para. 1.

<sup>282</sup> *Id.* art. 1, para. 3, and art. 7, para. 1; see also NASA-ESA MOU, *supra* note 43, art. 8. See text accompanying notes 40-51 (discussing the ISS “consensus management” regime).

<sup>283</sup> 1998 IGA, *supra* note 20, art. 9, para. 3(b).

<sup>284</sup> *Id.* art. 1, para. 1, and art. 2, para. 1.

related activities or experiments *only* when the Partner has reason to believe that the activities or experiments could cause “potentially harmful interference” with the activities of one or more of the other Partners.<sup>285</sup> Otherwise, each Partner is essentially free to decide how to best utilize its respective “user elements” within the bounds of international law.<sup>286</sup> Moreover, because the ISS occupies *outer space*, the “right to inspect” facilities, equipment and vehicles on the moon and other celestial bodies, which is afforded to state-parties to the OST on the basis of reciprocity in accordance with OST Article XII,<sup>287</sup> does not extend to the ISS or its elements.<sup>288</sup>

Yet, in the face of all this, Article 23 of the 1998 IGA gives each Partner the right to request consultations with each other on “*any matter* arising out of Space Station cooperation” and obligates all Partners to promptly accede to such requests and use their best efforts to settle disputes.<sup>289</sup> These provisions of the Agreement give rise to the question: Is the characterization of ISS activities (including commercial activities) as “peaceful” a “matter arising out of Space Station cooperation,” such that it can be made the subject of consultations, or perhaps even submitted to mediation, arbitration or some other form of dispute resolution?<sup>290</sup> Or, Is the determination of the Partner that provided the element where such activities are taking place conclusive of the issue? Obviously, if the answer to the first part of this query were “yes,” Article 23 would constitute a substantial (albeit procedural) restraint on a Partner’s utilization of the ISS for military purposes. However, neither the 1998 IGA nor the implementing MOU provide a definitive answer to this question.

Ambiguities in other aspects of the ISS “consensus management” regime likewise pose complications. Specifically, the 1998 IGA provides that use of the Space Station by “a non-Partner or private entity under the jurisdiction of a non-Partner” requires “consensus among all Partners.”<sup>291</sup> At the same time, an ISS Partner cannot refuse a fellow Partner access to resources derived from the Space Station infrastructure to support an ISS mission because they disagree with their fellow Partner’s determination that the mission is for peaceful purposes.<sup>292</sup> The question that logically follows then is whether a Partner can rightfully refuse to consent to use of the ISS by a

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<sup>285</sup> Outer Space Treaty, *supra* note 21, art. IX; *see also* 1998 IGA, *supra* note 20, art. 9, para. 4 (“[E]ach Partner... is to avoid causing serious adverse effects on the use of the Space Station by the other Partners.”).

<sup>286</sup> 1998 IGA, *supra* note 20, art. 7, para. 3; art. 9, para. 3; and art. 1, para. 1.

<sup>287</sup> *See supra* text accompanying notes 166-69.

<sup>288</sup> *See supra* sources cited at note 169.

<sup>289</sup> 1998 IGA, *supra* note 20, art. 23, para. 1-2 (emphasis added); NASA-ESA MOU, *supra* note 43, art. 18.

<sup>290</sup> *Id.* art. 23, paras. 2 and 4.

<sup>291</sup> *Id.* art. 9, para. 3(a).

<sup>292</sup> *Id.* art. 9, para. 3(b).

non-Partner (or a private commercial entity of a non-Partner) on the basis that they disagree with their fellow Partner's determination that the non-Partner's use is for peaceful purposes. Here again, there is the potential for a significant restriction on utilization of the Space Station for military-related activities, including those activities being carried out by or on-behalf of private industry. Once more, however, the 1998 IGA framework fails to provide any definitive guidance.

These questions, along with the broader legal issues raised by the prospect of commercial use of the ISS for the advancement of military aims,<sup>293</sup> must surely be counted among the many issues relating to the commercialization of the Space Station that remain unresolved and need to be addressed in any policy or political discussions toward that end.<sup>294</sup>

## V. CONCLUSION

Like a truck, a telephone, or a pair of binoculars, orbiting space stations have no inherent characteristics that make them civil or military; rather, it is how the space station is utilized that is key to determining its civil or military potential.<sup>295</sup> However, the decision of the ISS Partners to use the notoriously imprecise "peaceful purposes" phraseology without providing a definition of the term in the 1998 International Agreement (IGA) not only exposes the Partner States' divergent interpretations of the meaning of "peaceful," but also suggests that the Partner States may have differing views about how the ISS should, in fact, be utilized.

While analysis of the language of the 1998 IGA and the international law which institutes the requirement that outer space shall be used "exclusively for peaceful purposes" lends strong support to the position that the ISS can be used for military purposes provided such actions are "nonaggressive," the permissibility of military use of the Space Station will ultimately hinge on how the term "peaceful purposes" is interpreted and applied by the Partner States, both individually and collectively. Last year's controversy over the Russian Federation's decision to send American "space tourist" Denis Tito to the Space Station over the objection of the United States and other Partner States demonstrates how the limits of cooperation can be severely strained when one Partner State ignores the ISS goal of consensus management in favor of its own political and/or economic desires. To avoid similar controversies over the conduct of military-related activities onboard the Space Station, the ISS Partners, acting through their Cooperating Agencies, will have to match the

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<sup>293</sup> See e.g., *supra* text accompanying notes 256-59.

<sup>294</sup> See Logsdon, *supra* note 19, at 245-46.

<sup>295</sup> DOYLE, *supra* note 4, at 3. Each of the main uses of a permanent manned orbiting space station, including "observation," "space labs," and "mission staging" represent dual civil/military capabilities. DOYLE, *supra*, at 4.

foresight and skill already exhibited by scientists and engineers in the planning and construction of “Alpha,” in making future decisions about the operation and utilization of the facility.

# THE SOUNDS OF SILENCE: PROMOTING ALTERNATIVE DISPUTE RESOLUTION IN AIR FORCE PROCUREMENT BY PUTTING CONFIDENCE INTO CONFIDENTIALITY

MAJOR JOHN E. HARTSELL\*

*Santino, come here. What's the matter with you? I think your brain is going soft. . . . Never tell anybody outside the family what you're thinking again.*<sup>1</sup>

## I. INTRODUCTION

Litigation can be expensive, inefficient and acrimonious, and there is always the chance you will lose; on the other hand, alternative dispute resolution (ADR) can be inexpensive and efficient,<sup>2</sup> but there is always the chance you could end up worse off than if you had chosen to litigate. Remarkably, both litigation and ADR, its fashionable alternative,<sup>3</sup> are risky, but they are risky for entirely different reasons. The ultimate risk in litigation is the risk of losing. In ADR, the ultimate risk concerns confidentiality<sup>4</sup>—or lack thereof—in negotiations.

ADR negotiations can cause parties to reveal case strengths, weaknesses, strategies, and concerns in an effort to achieve resolution. Unfortunately, the lack of confidentiality protections in ADR negotiations may

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<sup>1</sup> THE GODFATHER. (Paramount Pictures 1972). In *The Godfather*, Vito Corleone admonishes his son for revealing family confidences during business negotiations. The revelations ultimately cause Vito to be shot and his son to be killed.

<sup>2</sup> See *infra* note 162 and accompanying text.

<sup>3</sup> ADR is fashionable but certainly not new. "Settle matters quickly with your adversary who is taking you to court. Do it while you are still with him on the way, or he may hand you over to the Judge and the Judge may hand you over to the officer, and you may be thrown in prison." Pamela A. Kentra, *Hear No Evil, See No Evil, Speak No Evil: The Intolerable Conflict for Attorney-Mediators Between a Duty to Maintain Mediation Confidentiality and the Duty to Report Fellow Attorney Misconduct*, 1997 BYU L. REV. 715, 717 (1997) (citing *Matthew* 5:25-26).

<sup>4</sup> The definition of "confidential" under federal law is found in the Administrative Dispute Resolution Act. 5 U.S.C. §§ 571-83 (2000). "Confidential" means "the information is provided—(A) with the expressed intent of the source that it not be disclosed; or (B) under circumstances that would create the reasonable expectation on behalf of the source that the information will not be disclosed." *Id.* § 571(7).

allow those revelations to be used against the party who made them.<sup>5</sup> Accordingly, the lack of adequate confidentiality has both the ability to make litigation more attractive and the ability to jeopardize the future of ADR in Air Force procurement; in this regard, “loose lips could sink gunships.”

ADR comes in many forms. In fact, the Federal Acquisition Regulation (FAR) definition of ADR includes multiple types of ADR:

Alternative Dispute Resolution (ADR) means any type of procedure or combination of procedures voluntarily used to resolve issues in controversy. These procedures may include, but are not limited to, conciliation, facilitation, mediation, fact-finding, minitrials, arbitration, and the use of ombudsmen.<sup>6</sup>

A common thread in many of these forms of ADR in federal procurement is the presence of a third party “who may be used to facilitate resolution of the issue in controversy using the procedures chosen by the parties.”<sup>7</sup> Generally speaking, the third party should be neutral and detached, and it is critical that the confidences made to him or her by the parties remain secret.<sup>8</sup>

Secrecy, or confidentiality, can be critical to dispute resolution<sup>9</sup> because it encourages parties and the neutral third party to freely exchange ideas and proposals with an eye towards resolving the dispute and avoiding an even greater conflict.<sup>10</sup> It allows parties to drop the finger pointing, drop their

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<sup>5</sup> Cf. Confidentiality in Federal Alternative Dispute Resolution Programs, 65 Fed. Reg. 83,085 (Dec. 29, 2000) (*Guidance*) (“Guarantees of confidentiality allow parties to freely engage in candid, informal discussions of their interests in order to reach the best possible settlement of their claims. A promise of confidentiality allows parties to speak openly without fear that statements made during an ADR process will be used against them later. Confidentiality can reduce posturing and destructive dialogue among parties during the settlement process.”).

<sup>6</sup> GENERAL SERVS. ADMIN. ET AL., FEDERAL ACQUISITION REG. 33.214(a) (JUNE 1997) [hereinafter FAR].

<sup>7</sup> *Id.* at 33.214(d).

<sup>8</sup> Charles Pou, Jr., *No Fear: Confidentiality Day-to-Day in Federal Dispute Resolution*, in FEDERAL ADMINISTRATIVE DISPUTE RESOLUTION DESKBOOK 76 (2001).

A neutral third party can enhance parties’ negotiations by holding separate meetings with each where they are able to speak candidly about their positions, interests, and alternatives. The neutral, without disclosing confidences, can then use the confidential data to shape the negotiations to reach settlements that meet parties’ interests most effectively.

*Id.* at 77.

<sup>9</sup> Pou, *supra* note 8, at 76. Congress, “[R]ecognized that parties would be less forthcoming if they knew disclosure to be a significant possibility, and that even one or two cases where expectations of confidentiality are undermined could precipitate a damaging loss of trust in the confidentiality of federal ADR processes as a whole.” *Id.*

<sup>10</sup> Kentra, *supra* note 3, at 722.

Confidentiality lies at the heart of the mediation process. Mediation would not be nearly as effective if the parties were not assured their discussions would remain private. Parties would be hesitant to bare their souls to someone who may be called as a witness against them in subsequent



guard, and through unpretentious discourse, ultimately drop lawsuits. On the other hand, half-baked confidentiality protections can allow parties to engage in half-hearted resolution efforts. Unfortunately, confidentiality protections in federal procurement fall into the latter category.

The current confidentiality protections in Air Force procurement are a loose, hodge-podge collection of statutes, rules, and agreements. Parties can conduct ADR one day under one factual scenario and then conduct ADR the following day under almost the same scenario and end up with entirely different results due to confidentiality issues.<sup>11</sup> Trying to understand which communications are protected and which are not can be maddening to the parties and threatening to the entire process. Weak confidentiality may cause parties to shy away from using ADR; moreover, it may allow parties to easily abuse ADR. ADR bears noble intentions, but the Freedom of Information Act<sup>12</sup> (FOIA) did as well, and a few prospective bidders have been known to try to use FOIA for a competitive advantage.<sup>13</sup> Confidentiality in Air Force procurement ADR needs to be strengthened to make it more consistent and effective.<sup>14</sup>

This article will examine the limits of ADR confidentiality under federal law and recommend changes to improve its protections. It will briefly examine the legal basis for federal ADR, explore the growth of ADR in Air Force procurement, and discuss the model used by the Air Force for ADR. Thereafter, it will identify the protections governing confidentiality and examine their most glaring weaknesses, including the failure to protect conduct during ADR negotiations, the need to establish protections for matters inadvertently made public during negotiations, the absolute mandate to create

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litigation. It is therefore essential to the success of the process that parties freely disclose information relating to the dispute. Confidentiality serves the crucial purpose of allowing the mediator to be seen by the parties as a neutral, unbiased third party.

*Id.*

<sup>11</sup> Subtle differences in ADR scenarios can result in drastically different results. A head nod, an overheard telephone call, or an innocuous discussion between parties can each result in a breach of confidentiality. The differences between a conversation protected by confidentiality and a conversation not protected by confidentiality can be insignificant, but the results can be disturbingly significant. *See infra* discussion Parts V-VII.

<sup>12</sup> 5 U.S.C. § 552 (2000).

<sup>13</sup> Nat'l Parks & Conservation Assoc. v. Morton, 498 F.2d 765 (D.C. Cir. 1974) (contractor seeking to use FOIA to discover financial information about a competing concessionaire). "The ADRA did not include an exemption from the disclosure requirements of the Freedom of Information Act ('FOIA')." Jeffrey M. Senger, *Turning the Ship of State*, 2000 J. DISP. RESOL. 79, 81 (2000) (citing Administrative Dispute Resolution Act of 1996, 5 U.S.C. §§ 571-584 (1994 & Supp. IV 1998)). Discovering how FOIA could be used to breach confidential communications, Congress later corrected the problem. *See* discussion *infra* Part II.

<sup>14</sup> While the comments herein address, for purposes of the primary intended audience, "Air Force procurement," virtually all of the analysis in this article is also applicable to the subject of federal procurement generally.

confidentiality for disclosures made between parties, and the creation of a formal process to make authorized disclosures. This article does not seek to thrust uniformity onto the entire ADR world. Instead, its primary purpose is to identify weaknesses in the confidentiality rules of Air Force procurement ADR and propose changes to governing legal provisions in an effort to strengthen ADR and establish it as a consistently advantageous alternative to litigation.

This article will employ an unconventional literary tool in order to highlight the importance of confidentiality: several, fictional cross-examination vignettes. The cross-examination vignettes are brief, purposely elementary, intended to illustrate the limitations of confidentiality under federal law and confidentiality concepts, and demonstrate precisely how painful it can be if ADR confidentiality is breached. Each cross-examination vignette is based upon the same basic fact pattern which is not derived from an actual case. For academic purposes, they do not address the objections that may invariably be made by the parties.

#### *Cross-Examination Vignette #1*

The fact pattern for the cross-examination vignettes is based upon a contract dispute. Imagine if you will, a solicitation to construct a small, unremarkable building on an Air Force installation. The Air Force receives over a dozen proposals, but Dojoro Construction, a reputable builder with decades of experience constructing facilities for the Air Force, is awarded the contract. Shortly thereafter, Dojoro begins performance. A few weeks before the facility is completed, the president of Dojoro Construction calls the contracting officer overseeing the project, Mr. Ko. The president asks Mr. Ko about a possible discrepancy in the blueprints. He tells Mr. Ko the new facility and the nearby grounds will need a storm drain in the event of a hurricane, and none is provided for in the blueprints. Mr. Ko tells the president, "Good catch, I missed that one. Well, if you think it's necessary, I don't see how anyone could begrudge the change." The president of Dojoro Construction considers the comment an affirmative authorization for a change, and performs the work. Meanwhile, Mr. Ko completely forgets the conversation.

A few weeks later, the president of Dojoro Construction presents Mr. Ko with a bill for the storm drain change. The bill is startlingly high. Mr. Ko complains he did not authorize any such change to the original contract and he refuses to pay. Understandably, the tenor of the disagreement escalates, and litigation looms. Nonetheless, the president of Dojoro Construction desires to maintain positive relations with the Air Force; therefore, he asks Mr. Ko if he would agree to try to mediate the matter. Mr. Ko agrees.<sup>15</sup>

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<sup>15</sup> The fact pattern is purposely rudimentary; it avoids a technical recitation of Air Force ADR procedures for the sake of simplicity. The focus of the fact pattern is on ADR confidentiality

The parties agree upon a mediator, Mr. Secretz, and upon mediation procedures. Mr. Secretz initiates the mediation proceedings by meeting with each party separately (in a caucus) in an effort to learn the nature of the conflict, the interests of the parties, and to foster cooperation. First, Mr. Secretz meets with the president of Dojoro. He assures the president that their discussions are confidential and tries to put the president at ease. The president tells Mr. Secretz about the phone call and after some discussion, the president reveals that in hindsight, he probably should have clarified Mr. Ko's alleged authorization before he started construction.

The next day, Mr. Secretz meets with Mr. Ko. Mr. Ko is ready for the mediation, and has even prepared a report for Mr. Secretz listing all the strengths and weaknesses of each party's case. Mr. Secretz patiently assures Mr. Ko that their discussions are confidential while Mr. Ko thoughtlessly flips through the Dojoro Construction ADR report he has in his briefcase. Mr. Secretz then asks Mr. Ko if there was ever any type of communication between the parties wherein Mr. Ko could have possibly authorized the change.

Suddenly, Mr. Ko, for the first time remembers the telephone call and is horrified. Mr. Ko slams his briefcase shut, his face turns red, his eyes bulge out, and he drops his head down into his hands and sighs. Mr. Secretz talks to Mr. Ko for another fifteen to twenty minutes, but all Mr. Ko can do is nod every time Mr. Secretz says, "It sounds like you may have authorized a change." Mr. Ko is unhappy, but he finally collects himself, sits up, and insists his comments were an observation not an authorization. Mr. Ko maintains that he will not pay for the change, demands a trial, and storms out of his meeting.

Mr. Ko is so upset with his past absentmindedness that he runs to his car, puts his briefcase on the roof of his car, unlocks the car door, gets in, and quickly drives away to an early lunch. Mr. Ko's briefcase majestically travels on the roof of his car for about one mile and then falls off and lands on a nearby Dojoro Construction work site where a Dojoro employee fatefully discovers it.

### *Cross-Examination Vignette #2*

Imagine a second fictional conflict that arises as a direct result of the storm drain change. Mr. Loser, an unsuccessful offeror from the Air Force building solicitation, learns that Dojoro Construction is seeking payment for constructing the storm drain. Mr. Loser is convinced the storm drain is an "out-of-scope" project, and believes Dojoro Construction is attempting to avoid competition. Mr. Loser is convinced that the president of Dojoro Construction has benefited, over the years, from parochialism. He also

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rather than the actual ADR process. For a discussion of actual Air Force ADR procedures, *see infra* Parts III.B. & Appendix A. *See also* Major Patrick E. Tolan, Jr., *Using ADR to Resolve Contract Disputes Between Contractors and the Air Force*, in *FEDERAL ADMINISTRATIVE DISPUTE RESOLUTION DESKBOOK* (2001).

believes that Dojoro has continually escaped termination for default actions on other projects and always gets out-of-scope changes authorized. As a result, Mr. Loser files his own suit.

### *Cross-Examination Vignette #3*

The following fictional cross-examination vignette by government counsel of Mr. Secretz, the mediator, graphically illustrates the absolute need for some degree confidentiality in ADR.

Q: Mr. Secretz, you were a mediator between the two parties, Dojoro Construction and the Air Force?

A: That is correct.

Q: And as I understand it, a mediator serves as a neutral third party who encourages negotiating parties to come to a mutually beneficial consensus?

A: Generally speaking, yes.

Q: Is it true that a mediator will meet with each party privately in an effort to encourage this consensus?

A: Yes. If the parties decide to do that they can.

Q: And ordinarily these private discussions are confidential, meaning you don't tell anyone what you've heard right?

A: They are intended to be confidential.

Q: I see. During these secret little meetings you have, do parties reveal things to you that they don't want anyone else to know?

A: It's not confessional in nature, but yes, often a party reveals company secrets or agency confidences, but only so I can consider their concerns in a matter.

Q: In this case, did you tell your confidant here (pointing a finger at the president of Dojoro Construction) that he was free to tell you anything he wanted and you would do your best to hide that information from the Air Force?

A: Hide it? No. Protect it, certainly. But of course, you found a way around that protection counselor. The parties...

Q: ...and of course, since this was mediation, if he was open and forthright with you, it would presumably improve his chances of resolving this high dollar matter?

A: Yes, that's logical.

Q: Now, as a mediator, do you remind parties of the rewards and financial incentives for being open, candid, and forthright?

A: I remind them, but I believe the process encourages it as well.

Q: Mr. Secretz, given the financial incentives for being forthright and the encouraging effect both you and the process had, let's talk about what you learned during this secret little meeting?

A: (Turning to the judge.) Your Honor, I'd like to renew my objections to revealing these matters. The parties never expected their admissions to become public; they never intended their documents to be discoverable. My role as a mediator should be sacrosanct.

Judge: Overruled Mr. Secretz. Our lawmakers had a chance, even the parties had a chance, to make these matters confidential, but they declined. Proceed with the cross-examination counselor.

Q: Thank you Your Honor. Mr. Secretz, did you say you had documents, too?

This hypothetical cross-examination demonstrates that the president of Dojoro Construction would have had a financial incentive and an assurance of confidentiality to act and speak candidly to the neutral party. Hence, any revelations are extremely powerful and potentially incriminatory. The use of a party's confidences, in a courtroom could make or break a litigated case. Revelations of this sort could make or break the future of ADR.

## II. THE LEGAL BASIS FOR FEDERAL ADR

The Administrative Dispute Resolution Act (ADRA),<sup>16</sup> the legal basis for ADR in the federal government, has been in operation for a relatively short period of time. Its purpose is to authorize and govern the use of ADR in federal agencies.<sup>17</sup> One particular area the ADRA governs closely is confidentiality and the disclosure of protected communications.<sup>18</sup> The ADRA has evolved over time, and has had the benefit of legislative reflection and amendment.

The ADRA was originally enacted in 1990 to encourage federal agencies to use ADR.<sup>19</sup> Congress wanted to offer an expeditious and inexpensive means to resolve disputes rather than restrict itself to formal, federal administrative forums.<sup>20</sup> When enacted, the ADRA contained a sunset provision, indicating that the legislation would expire after five years.

The 1990 Act had some problems that created challenges for ADR advocates. One of the most significant challenges concerned confidentiality. Congress had failed to carve out a FOIA exemption to the ADRA.<sup>21</sup> "Therefore any citizen could request copies of any federal records of confidential dispute resolution communications merely by filing a FOIA claim

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<sup>16</sup> 5 U.S.C. §§ 571-83 (2000).

<sup>17</sup> Diane R. Liff, *Administrative Dispute Resolution Act of 1996*, in *FEDERAL ADMINISTRATIVE DISPUTE RESOLUTION DESKBOOK* 35 (2001).

<sup>18</sup> 5 U.S.C. § 574.

<sup>19</sup> Senger, *supra* note 13, at 81.

<sup>20</sup> Tolan, *supra* note 15, at 286-99.

<sup>21</sup> Senger, *supra* note 13, at 81.

with the agency.”<sup>22</sup> Another challenge concerned the definition of ADR. The language of the Act included “settlement negotiations” as a type of ADR procedure.<sup>23</sup> As a result, practitioners in Air Force procurement litigation who were merely negotiating settlements believed they were successfully engaging in ADR; this “slowed implementation of third-party assisted ADR.”<sup>24</sup>

These problems were resolved in the Act’s reauthorization.<sup>25</sup> “In the new Act, confidential communications between the parties and the neutral are explicitly exempted from FOIA.”<sup>26</sup> This change “permit[s] agencies to communicate their settlement positions more freely.”<sup>27</sup> Additionally, settlement negotiations were eliminated as a form of ADR.<sup>28</sup> Since that time, the ADRA has become a welcome piece of legislation,<sup>29</sup> “imbedded as a tool used by the Air Force to resolve disputes.”<sup>30</sup>

### III. AIR FORCE ACQUISITIONS AND THE USE OF ADR

#### A. The Growth of ADR in Air Force Procurement

The term “alternative dispute resolution” has all but become a misnomer in the Air Force: ADR is no longer just an alternative. There has been a conscious and consistent effort to take the “A” out of ADR<sup>31</sup> and utilize it to the maximum extent practicable.<sup>32</sup> The effort to maximize ADR in the Air Force does not appear to be a passing fancy.

Department of Defense (DoD) policy is that, “[a]ll DoD Components shall use ADR techniques as an alternative to litigation or formal administrative proceedings whenever appropriate. Every dispute, regardless of subject matter, is a potential candidate for ADR.”<sup>33</sup> In 1999, F. Whitten Peters, the Acting Secretary of the Air Force, stated that, “[t]he Air Force

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<sup>22</sup> *Id.* at 80.

<sup>23</sup> Tolan, *supra* note 15, at 290 (citing 5 U.S.C. § 571).

<sup>24</sup> *Id.* at 291.

<sup>25</sup> Senger, *supra* note 13, at 81.

<sup>26</sup> *Id.* at 81 (citing 5 U.S.C. § 574(j)). Jonathon D. Mester, *The Administrative Dispute Resolution Act of 1996: Will the New Era of ADR in Federal Administrative Agencies Occur at the Expense of Public Accountability?*, 13 OHIO ST. J. ON DISP. RESOL. 167, 168 (1997).

<sup>27</sup> Peter R. Steenland, Jr. & Peter A. Appel, *The Ongoing Role of Alternative Dispute Resolution in Federal Government Litigation*, 27 U. TOL. L. REV. 805, 819 (1996).

<sup>28</sup> Tolan, *supra* note 15, at 291.

<sup>29</sup> Mester, *supra* note 26, at 168.

<sup>30</sup> Tolan, *supra* note 15, at 286.

<sup>31</sup> Darleen Druyun, A Quiet Revolution in Managing Contract Controversies, Address Before the ABA Public Contract Law Section (Apr. 26, 1999) [hereinafter ADR First Speech], available at <http://www.adr.af.mil/afadr/druyunspeech.htm>.

<sup>32</sup> *Id.* (citing Policy Letter, F. Whitten Peters, subject: Implementation of the Administrative Dispute Resolution Act of 1996 (Apr. 21, 1996) [hereinafter AF ADR Policy Letter]).

<sup>33</sup> U.S. DEP’T OF DEFENSE, DIR. 5145.5, ALTERNATIVE DISPUTE RESOLUTION para. A (Apr. 22, 1996).

remains fully committed to fostering the use of ADR.”<sup>34</sup> As a result, Air Force policy is “to use ADR to the maximum extent practicable and appropriate to resolve disputes at the earliest state feasible, by the fastest and least expensive method possible, and at the lowest possible organizational level.”<sup>35</sup>

The results of this policy in Air Force procurement unquestionably compel the use of ADR. In October of 2000, the *Federal Contracts Report* noted that the Air Force estimates the total value of all contract disputes resolved by ADR at about \$1 billion.<sup>36</sup> The same year, the Air Force reported that it had attempted ADR in a total of ninety-four contract appeals and that there was a ninety-three percent resolution rate.<sup>37</sup> In 2001, fifty to seventy percent of the cases proceeding toward litigation at the board of contract appeals were re-directed to ADR.<sup>38</sup> In 2001, Air Force ADR cases were resolved within 121 days while a case proceeding to the appeals board took twelve to eighteen months before the board ever rendered a final decision.<sup>39</sup>

Speedy resolution also potentially saves money in interest. “Since the Air Force is also required to pay Contract Disputes Act interest on claims from the date of the contracting officer’s final decision until payment is made, quicker resolution significantly reduces the Air Force’s interest expenses.”<sup>40</sup> As a result, the Air Force has saved millions in interest payments.<sup>41</sup> Alternative dispute resolution in Air Force procurement has tremendous promise and potential; therefore, it’s weaknesses and pitfalls should be corrected before they negatively affect a rewarding and remarkable program.

## **B. The Air Force Alternative Dispute Resolution Model**

The Air Force ADR model for contract controversies is designed to encourage ADR before an appeal of a contracting officer’s final decision.<sup>42</sup> The first element of the model addresses resolution through simple negotiation.<sup>43</sup> If the Air Force and a contractor determine that ADR is in their

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<sup>34</sup> AF ADR Policy Letter, *supra* note 32.

<sup>35</sup> U.S. DEP’T OF AIR FORCE POLICY DIR. 51-12, ALTERNATIVE DISPUTE RESOLUTION (Apr. 1, 1999).

<sup>36</sup> Martha Mathews, *Air Force Launches Joint ADR Training Effort, Cites Resolution of \$1B in Contract Disputes*, 74 FED. CONT. REP 350, 350-52 (Oct. 17, 2000).

<sup>37</sup> *Id.*

<sup>38</sup> Captain Kim D’Ippolito, *Air Force Materiel Command Leading the Way in “ADR First Policy”* LEADING EDGE, Aug. 2001, available at <http://www.adr.af.mil/afadr/afmcaadrfirst.htm>.

<sup>39</sup> *Id.*

<sup>40</sup> *Id.*

<sup>41</sup> *Id.*

<sup>42</sup> Martha Mathews, *Air Force Makes Good on Promise to Rely on ADR in Contract Disputes* 73 FED. CONT. REP. 152, 152-54 (8 Feb. 2000).

<sup>43</sup> AF ADR PROGRAM OFFICE, REPORT TO THE PRESIDENT OF THE UNITED STATES AND THE SECRETARY OF THE AIR FORCE FOR FISCAL YEAR 1999 (1999) [hereinafter REPORT TO THE PRESIDENT ON AF ADR] (“If negotiations do not result in a timely settlement (unresolved for more than 12 months) or if the estimated value of the issue is significant (more than \$10

best interests, the parties will then need to agree upon a number of negotiation issues. The ADR process must be agreed upon, timelines and methods must be established, an ADR agreement must be drafted, and an appropriate third-party neutral needs to be identified.<sup>44</sup> A flowchart of the Air Force ADR model for contract controversies is displayed at Appendix A.<sup>45</sup>

Air Force procurement officials have further tailored the ADR model, in a number of cases, by establishing standing corporate level ADR agreements with the Air Force's top contractors.<sup>46</sup> The agreements establish "tailored rules of engagement" in the event of a future contract dispute.<sup>47</sup> They help structure a particular ADR model between the Air Force and the contractor, in advance, in the event a contract conflict arises. These agreements are individually drafted and do not apply across the board (to all contractors) like a FAR clause would; however, they do promote the use of ADR between the Air Force and the top suppliers to the Air Force.<sup>48</sup>

The Air Force has made a concerted effort to ensure "[t]hese agreements—which can either be a memoranda of understanding between the Air Force program offices and their industry partners or a special contract requirement contained in the contract—will cover the Air Force's forty largest programs and their prime contractors, or between sixty-five and seventy percent of Air Force contract dollars."<sup>49</sup> The goal of these program-level agreements is to commit Air Force "program managers, contracting officers and their industry partners to using ADR first—promoting constructive long-term business relationships and reducing the time and cost associated with resolving contract controversies."<sup>50</sup>

#### IV. THE IMPORTANCE OF CONFIDENTIALITY

As discussed above, ADR has become increasingly prominent in the U.S. government's approach to resolving contract disputes.<sup>51</sup> "It is generally

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million when received), the Contracting Officer will refer the matter to [an] Air Force Advisory Team for advice on the use of ADR.")

<sup>44</sup> Five Year Plan, SAF/IQ, subject: Air Force Alternative Dispute Resolution (ADR) Plan for Contract Controversies (9 July 1999) [hereinafter 5 Year Plan]; Mathews, *supra* note 42, at 152-54.

<sup>45</sup> See *infra* Appendix A.

<sup>46</sup> Mathews, *supra* note 42, at 152-54.

<sup>47</sup> 5 Year Plan, *supra* note 44.

<sup>48</sup> REPORT TO THE PRESIDENT ON AF ADR, *supra* note 43.

<sup>49</sup> Martha Mathews, *Air Force Launches New Push for ADR Use; Drafts Legislation to Fund ADR Settlements*, 71 FED. CONT. REP. 608-09 (May 3, 1999).

<sup>50</sup> Memorandum from Darleen A. Druyun, Principal Deputy Assistant Secretary (Acquisition & Management), to Air Force Acquisition Personnel, subject: Lightning Bolt (LB) 99-04, Alternative Dispute Resolution (18 Aug. 1999), available at <http://www.safaq.hq.af.mil/contracting/toolkit/adr/adr-druyunmemo-18aug99.pdf>.

<sup>51</sup> Marshall J. Breger & Gerald S. Schatz, *Federal Administrative Dispute Resolution: An Overview*, in FEDERAL ADMINISTRATIVE DISPUTE RESOLUTION DESKBOOK 76 (2001).



thought that an expectation of confidentiality on the part of participants is critical to a successful [ADR] process.”<sup>52</sup> The law regarding confidentiality, however, is neither completely consistent nor completely effective. The law includes a collection of statutes (the ADRA and the FAR), rules of evidence and civil procedure, and corporate level agreements. If parties lack confidence in confidentiality they “could well begin to worry that their communications might indeed be used against them later and decide to avoid mediating with the government altogether.”<sup>53</sup> Therefore, it is necessary to examine the current law on confidentiality, identify weaknesses in it, and seek corrective measures if Air Force ADR participants hope to maintain a reasonable measure of confidence in confidentiality.

One might argue that changes are unnecessary. Air Force leadership and procurement personnel promote ADR, corporations voluntarily agree to engage in ADR, and the results themselves illustrate that ADR is a resounding success even without consistent and effective laws regarding confidentiality. At first glance, one might proffer that if the results are positive, then maybe the confidentiality rules simply are not a problem. Some proponents of Air Force ADR might suggest that, “If it ain’t broke, don’t fix it.” Nonetheless, this logic is flawed. Air Force ADR is simply too immature to be able to rely on its past successes, and confidentiality is too important to depend upon banal colloquialisms and naïve logic. The importance of confidentiality is an axiom of ADR because it protects the present disclosures and future successes of ADR.<sup>54</sup>

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<sup>52</sup> Owen W. Gray, *Protecting the Confidentiality of Communications in Mediation*, 36 OSGOODE HALL L.J. 667, 670 (1998) (citing J. FOLBERG & A. TAYLOR, *MEDIATION: A COMPREHENSIVE GUIDE TO RESOLVING CONFLICTS WITHOUT LITIGATION* 264 (1984); L.R. Freedman & M.L. Prigoff, *Confidentiality in Mediation: The Need for Protection*, 2 OHIO ST. J. ON DISP. RESOL. 37 (1986); M.L. Prigoff, *Toward Candor or Chaos: The Case of Confidentiality in Mediation*, 12 SETON HALL LEGIS. J. 1 (1988); A. Kirtley, *The Mediation Privilege’s Transition from Theory to Implementation: Designing a Mediation Privilege Standard to Protect Mediation Participants, the Process and the Public Interest*, J. DISP. RESOL. 1, 8 (1995); and *Protecting Confidentiality in Mediation*, Note, 98 HARV. L. REV. 441, 444-45 (1984). *But see* Gray, *supra* (citing E.D. Green, *A Heretical View of the Mediation Privilege*, 2 OHIO ST. J. ON DISP. RESOL. 1 (1986); and K. Gibson, *Confidentiality in Mediation: A Moral Reassessment*, J. DISP. RESOL. 25, 40 (1992)).

<sup>53</sup> Pou, *supra* note 8, at 76.

<sup>54</sup> Ellen E. Deason, *Enforcing Mediated Settlement Agreements: Contract Law Collides With Confidentiality*, 35 U.C. DAVIS L. REV. 33, 35 (2001). In her article, Deason examines the parameters of confidentiality when there is an attempt to enforce a mediated settlement agreement. Deason stresses, “[Confidentiality] is necessary to foster the neutrality of the mediator and essential if parties are to participate fully in the process.” *Id.* *See also*, Peter Marksteiner, *How Confidential Are Federal Sector Employment-Related Dispute Mediations?* 14 OHIO ST. J. ON DISP. RESOL. 89, 89, and 155 (1998) (citations omitted). In his article, Marksteiner dissects the confidentiality provisions of the ADRA and analyzes the future of mediation in Air Force labor disputes. He acknowledges the importance of confidentiality and later concludes, “Mediation will continue to be an effective way to resolve employment-related

## V. SOURCES OF CONFIDENTIALITY PROTECTIONS IN FEDERAL ADR

### A. The Confidentiality Protections of Federal Rule of Evidence 408

A party who engages in ADR may do so for any number of reasons. A party may have numerous lawsuits pending against them and seek ADR as a means of resolving his or her lesser suits. The party may have a weak case and seek a forum that allows him or her to negotiate liability downward. On the other hand, a party may have a strong case, but he or she may desire a quick, expedient resolution through ADR. A party may even want to mediate a case in an effort to maintain cordial relations with the opposing party. There are any number of reasons why a party might seek ADR, but a skillful litigator could make a factfinder focus on only one reason: fault. Imagine the following fictional cross-examination of the president of Dojoro Construction by government counsel, highlighting fault and equating fault with liability.

Q: Sir, you are the President of Dojoro Construction?

A: Yes.

Q: And yesterday you told us all about your particular complaints against the Air Force?

A: That's correct.

Q: And you tried to convince us that it was the big, bad Government's fault?

A: It certainly was.

Q: And you honestly, truly believe you are in the right?

A: Absolutely.

Q: In fact, you believe you were right with such firm, unequivocal conviction, that YOU went to them, and YOU asked them if they would let YOU settle?

A: I asked if they wanted to mediate the issue.

Q: Let me see if I have this right, you honestly thought you'd win at trial, but tried to keep this out of court?

A: Yes.

Q: Do you naturally surrender when you have a strong case?

A: No.

Q: So this was a conscious decision for your allegedly strong case?

A: Um ...<sup>55</sup>

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disputes in the Air Force as long as the confidentiality of private caucuses between the mediator and the parties is strictly protected." *Id.*

<sup>55</sup> The above cross-examination would not occur in the Federal system because Federal Rule of Evidence 408 (Rule 408) ensures that such matters are inadmissible. FED. R. EVID. 408:

Rule 408 prohibits the admissibility of evidence of compromise as well as offers to compromise in order to prove liability.<sup>56</sup> It also restricts the use of evidence derived from those compromise efforts.<sup>57</sup> The rule applies equally to situations in which the evidence of compromise arises out of the same case and to situations in which the evidence of compromise arises out of a previous related case between either of the parties.<sup>58</sup> The intent of the prohibition is “to allow free and open bargaining in which the parties could make concessions for bargaining purposes that they would not later have to explain.”<sup>59</sup> The prohibitions even apply to nonparties who may attempt to use the compromise evidence in an entirely different case.<sup>60</sup>

The scope of Rule 408 at first blush might lead one to believe no other confidentiality protections are necessary under federal law. Rule 408 extends from pretrial negotiations through trial and post-trial proceedings. Rule 408 applies to the immediate parties as well as to third parties. It is a strict prohibition with a limited number of exceptions. Those exceptions, however, create a tremendous challenge to complete confidentiality.<sup>61</sup>

First, Rule 408 “does not require exclusion when the evidence is offered for another purpose, such as *proving bias or prejudice of a witness*, negating a contention of undue delay, or proving an effort to obstruct a criminal investigation or prosecution.”<sup>62</sup> Hence, Rule 408 appears to allow

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Evidence of (1) furnishing or offering or promising to furnish, or (2) accepting or offering or promising to accept, a valuable consideration in compromising or attempting to compromise a claim which was disputed as to either validity or amount, is not admissible to prove liability for or invalidity of the claim or its amount. Evidence of conduct or statements made in compromise negotiations is likewise not admissible. This rule does not require the exclusion of any evidence otherwise discoverable merely because it is presented in the course of compromise negotiations. This rule also does not require exclusion when the evidence is offered for another purpose, such as proving bias or prejudice of a witness, negating a contention of undue delay, or proving an effort to obstruct a criminal investigation or prosecution.

<sup>56</sup> *Id.*

<sup>57</sup> *Id.* (“Evidence of conduct or statements made in compromise negotiations is likewise not admissible.”).

<sup>58</sup> STEPHEN A. SALTZBURG ET AL., FEDERAL RULES OF EVIDENCE MANUAL 599 (7<sup>th</sup> ed. 1998) (citing *Fiberglass Insulators, Inc. Dupuy*, 856 F.2d 652 (4<sup>th</sup> Cir. 1988)).

<sup>59</sup> *Id.* at 599.

<sup>60</sup> *Id.* at 601 (“Thus, the fact that a party settled a litigation with another is not admissible to prove the validity or amount of the claim currently before the Court.”).

<sup>61</sup> W. Brazil, *Protecting the Confidentiality of Settlement Negotiations*, 39 HASTINGS L. J. 955 (1988). In his article Brazil comments, “The bottom line of this Article’s analysis will be disheartening to some: despite the policy that inspires rule 408, there are many circumstances in which the things that lawyers and clients say and do during settlement negotiations will not be protected from disclosure or barred from use at trial.” *Id.* at 957.

<sup>62</sup> See FED. R. EVID. 408 (emphasis added).

any party, at any time, to pierce ADR confidentiality in search of bias or prejudice of a witness.

Second, the “rule does not require the exclusion of any evidence *otherwise discoverable* merely because it is presented in the course of compromise discussions.”<sup>63</sup> Rule 408, generally protects records, statements, and agreements resulting from ADR efforts, in the courtroom, but they are accessible outside of court by discovery rules that are separate and distinct from Rule 408. “Rule 408 is a preclusionary rule, not a discovery rule. It is meant to limit the introduction of evidence of settlement negotiations at trial and is not a broad discovery privilege.”<sup>64</sup> Hence, evidence of compromise, offers to compromise, and evidence of conduct or statements made in compromise discussions can be discoverable under the Federal Rules of Civil Procedure if they will lead to admissible evidence.<sup>65</sup>

Discovery is governed by Federal Rule of Civil Procedure 26 (Rule 26). This Rule is a truly broad rule and it is liberally construed.<sup>66</sup> Federal Rule of Civil Procedure 26(b)(1) reads in part, “[i]t is not grounds for objection [to a discovery request] that the information sought will be inadmissible at the trial if the information sought appears reasonably calculated to lead to the discovery of admissible evidence.”<sup>67</sup> Additionally, efforts to defend against discovery seeking matters originating in compromise negotiations may be doomed by case law encouraging broad discovery, “[o]therwise, parties would be unable to discover compromise offers which could be offered for a relevant purpose.”<sup>68</sup> One can foresee endless discovery requests for ADR matters alleging that the requestor needs access to such matters ordinarily covered by Rule 408 in order to determine whether or not the information contained therein could be admissible at trial to prove, for example, the bias or prejudice of a witness.<sup>69</sup>

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<sup>63</sup> *Id.* (emphasis added).

<sup>64</sup> *Computer Associates Int’l, Inc. v. Am. Fundware, Inc.*, 831 F. Supp. 1516, 1531 (D. Colo. 1993) (citing *NAACP Legal Defense Fund v. United States Dep’t of Justice*, 612 F. Supp. 1143, 1146 (D.D.C. 1985)).

<sup>65</sup> *Morse/Diesel Inc. v. Trinity Industries, Inc.*, 142 F.R.D. 80, 85 (S.D.N.Y. 1992); *Manufacturing Systems, Inc. of Milwaukee v. Computer Technology, Inc.*, 99 F.R.D. 335, 336 (E.D. Wis. 1983).

<sup>66</sup> *Trinity*, 142 F.R.D. at 83 (citing J. WEINSTEIN & M. BERGER, *EVIDENCE*, ¶ 408[1], at 408-15 to 408-16 (1986)).

<sup>67</sup> See FED. R. CIV. P. 26(b)(1).

<sup>68</sup> *Morse/Diesel Inc. v. Trinity Indus., Inc.*, 122 F.R.D. 447, 449 (S.D.N.Y. 1988) (citing *NAACP*, 612 F. Supp. at 1143, 1146) *aff’d*, 142 F.R.D. 80.

<sup>69</sup> Maureen A. Weston, *Checks on Participant Conduct in Compulsory ADR: Reconciling the Tension in the Need for Good-Faith Participation, Autonomy, and Confidentiality*, 76 *IND. L.J.* 591 (2001). Weston raises concerns over ADR being used simply as a discovery tool. She writes,

As the use of compulsory ADR continues to rise, concerns that behind the closed doors of an ADR proceeding participants may engage in abusive conduct, use the process simply as a subterfuge for discovery, or fail to

Imagine the following hypothetical cross-examination of the mediator (Mr. Secretz) wherein Rule 408 is in place but Mr. Loser's (the unsuccessful offeror's) counsel nevertheless seeks ADR negotiation information in an effort to prove parochialism between the Air Force and Dojoro Construction.

Q: Mr. Secretz, are you aware why I've asked you to testify at this hearing?

A: I presume it has something to do with the fact that I have mediated several disputes between the Air Force and Dojoro Construction?

Q: Are you aware that the Air Force, for several years now, has awarded numerous high-dollar contracts to Dojoro Construction rather than to my client?

A: No.

Q: But you are aware that the Air Force and Dojoro have had numerous disputes regarding the numerous contracts between them?

A: Sure.

Q: And despite those disputes, the Air Force, for some particular reason, has never terminated any contract with Dojoro Construction?

A: I believe you are correct.

Q: So it seems that Dojoro Construction gets lots of lucrative contracts and no matter what they do wrong, no matter how bad, the Air Force never terminates the procurement?

A: I wouldn't say anyone did anything wrong, but if there's a dispute, mediation is the tool that helps resolve it.

Q: That's your opinion isn't it?

A: Well, yes.

Q: You really don't know, with absolute certainty, if this cozy relationship is the result of successful mediation or simply favoritism?

A: Ah, no.

Q: Would you agree that in order to determine if there was any favoritism or bias in the procurements, we'd want to know the severity of any contract dispute and how much either side was willing to accommodate the other?

A: Well, um, it could help.

Q: Of course it could. Let's turn now to the contract disputes, your mediation discussions, and why the disputes were settled rather than terminated shall we?

Bias is the allegation in the above fictional scenario, and bias is both a discovery and an in-court exception to Rule 408; hence, virtually any

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participate in a meaningful matter raise the questions of what can be done to address participant misconduct or abuse in ADR and to ensure basic procedural fairness.

*Id.* at 595 (citations omitted).

unsuccessful offeror can navigate around the protections of Rule 408 and discover confidential matters with Rule 26 and a simple allegation of favoritism. In this regard, the confidentiality protections of Rule 408 are little more than a paper tiger.

After unhappy contractors lose a bid more than one time to the same competitors, it is only natural for them to consider some degree of parochialism as an explanation for the losing bids—providing they believe their own bids should have won. Contractors suspecting favoritism can illustrate their unease with a bid protest on the grounds of bias which is a clear exception to Rule 408.

Rule 408 does not provide the confidentiality necessary for ADR because it allows various confidential matters to be revealed both through discovery and in the courtroom. Any unsuccessful offeror, with a little effort and a little imagination, can fashion a credible allegation of bias and enjoy a fair chance at running roughshod over Rule 408 protections.<sup>70</sup> So while Rule 408 does form a fair, first-line defense in protecting confidentiality, it does not provide sufficiently effective confidentiality necessary to instill complete confidence in ADR. Fortunately, the ADRA provides some additional assistance.<sup>71</sup>

## **B. The Confidentiality Protections of the ADRA**

The protections offered under the ADRA form a second line of defense (after Rule 408's protections) in defending confidentiality.<sup>72</sup> The confidentiality protections provided under the ADRA are detailed and can be confusing.<sup>73</sup> Generally speaking, under the ADRA, confidentiality protections

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<sup>70</sup> Kentra, *supra* note 3, at 729. “However, Rule 408 is fraught with exceptions, many of which raise serious concerns to whether essential portions of the mediation process would be deemed confidential.” *Id.*

<sup>71</sup> 5 U.S.C. §§ 571-83 (2000). In his article, *Protecting the Confidentiality of Settlement Agreements*, Brazil reminds his reader that FED. R. EVID. 403 (Rule 403) can also provide Rule 408 with some protective assistance. Brazil, *supra* note 61, at 988. Rule 403 states, “Although relevant, evidence may be excluded if its probative weight is substantially outweighed by the danger of unfair prejudice, confusion of the issues, or misleading the jury, or by considerations of undue delay, waste of time, or needless presentation of cumulative evidence.” FED. R. EVID. 403. Brazil writes, “[I]t is entirely appropriate to invoke Rule 403 to oppose the admission of settlement evidence that rule 408 would not automatically bar.” Brazil, *supra* note 61, at 988. Brazil's reliance on Rule 403 is justified if the issue of confidentiality is ever brought before a judge. However, Rule 403 is too amorphous to provide any practical guidance to the parties or neutrals who are trying to understand the parameters of ADR's confidentiality protections on a day-to-day basis.

<sup>72</sup> In fact, some argue it provides too much confidentiality at the expense of the public's right to know. See Mester, *supra* note 26, at 185-86.

<sup>73</sup> Pou, *supra* note 8, at 76. “In creating a confidentiality section that is the most detailed of any federal or state ADR statute, Congress gave parties in federally related ADR proceedings

extend to confidential communications between a neutral and a party and between a party and a neutral,<sup>74</sup> but these protections do not rise to the level of a privilege.<sup>75</sup> In fact, the ADRA permits disclosure under a number of circumstances, and it restricts the situations in which confidentiality applies. Hence, even under the ADRA, confidentiality is limited.

### *1. Disclosure by a Neutral Under the ADRA*

The ADRA prohibits a neutral from voluntarily disclosing or being required to disclose, through discovery or compulsory process,<sup>76</sup> dispute resolution communications or communications provided to them in confidence.<sup>77</sup> The ADRA defines dispute resolution communications as oral or written communications “prepared for the purposes of a dispute resolution proceeding.”<sup>78</sup> The dispute resolution proceeding occurs when specified parties participate, a neutral third party is appointed, and an alternative means of dispute resolution is used.<sup>79</sup> Dispute resolution communications include the memoranda, notes, and work product of the neutral, parties, and nonparty participants.<sup>80</sup> Conduct and actions are not included in the definition of dispute resolution communications; and written agreements to enter into dispute resolution, final written agreements, and arbitral awards are

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an assurance that their dispute resolution communications would generally be ‘immune from discovery,’ and defined these protections in detail.” *Id.*

<sup>74</sup> Marksteiner, *supra* note 54, at 102.

<sup>75</sup> *In re: Grand Jury Subpoena Dated Dec. 17, 1996*, 148 F.3d 487, 492 (5<sup>th</sup> Cir. 1998) (*citing* *Nguyen Da Yen v. Kissinger*, 528 F.2d 1194, 1205 (9<sup>th</sup> Cir. 1975) (“‘Confidential’ does not necessarily mean ‘privileged.’”)).

<sup>76</sup> 5 U.S.C. §§ 571(5), 574 (2000). Although Rule 408’s protections were limited during discovery, the ADRA’s umbrella of protections specifically includes discovery of written and oral confidential communications.

<sup>77</sup> *Id.* § 574(a) (“Except as provided in subsections (d) and (e), a neutral in a dispute resolution proceeding shall not voluntarily disclose or through discovery or compulsory process be required to disclose any dispute resolution communication or any communication provided in confidence to the neutral . . .”).

<sup>78</sup> *Id.* § 571(5).

‘[D]ispute resolution communication’ means any oral or written communication prepared for the purposes of a dispute resolution proceeding, including any memoranda, notes or work product of the neutral, parties or nonparty participant; except that a written agreement to enter into a dispute resolution proceeding, or final written agreement or arbitral award reached as a result of a dispute resolution proceeding, is not a dispute resolution communication . . .

*Id.*

<sup>79</sup> *Id.* § 571(6) (“[D]ispute resolution proceeding’ means any process in which an alternative means of dispute resolution is used to resolve an issue in controversy in which a neutral is appointed and specified parties participate . . .”).

<sup>80</sup> *Id.* § 571(5).

specifically excluded.<sup>81</sup> Finally, communications provided in confidence come into existence when they are made with the express intent that they not be disclosed or under circumstances that would create a reasonable expectation by the source that they will not be disclosed.<sup>82</sup>

The ADRA grants neutrals more confidentiality protection than Rule 408 does, but like Rule 408, it contains several enumerated exceptions. A neutral third party may disclose confidential communications in four circumstances. First, the neutral may disclose confidential communications if all parties (and participating non-parties [*e.g.* an expert providing testimony]) to the ADR agree to disclosure.<sup>83</sup> Second, the neutral may disclose communications that have already been made public.<sup>84</sup> This exception is broad; it would cover intentional as well as inadvertent disclosures. Third, the neutral may disclose confidential communications if required by law.<sup>85</sup> Fourth, the neutral may disclose confidential communications if a court determines it necessary to prevent a manifest injustice, establish a crime; or if it would prevent harm to public health or safety.<sup>86</sup> While confidentiality protections held by a neutral are not absolute, they are significantly better than the protections held by the actual disputing parties.

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<sup>81</sup> *Id.* (Even though the ADRA does not protect discovery of agreements to enter into ADR or final written agreements, Rule 408 prevents their use at trial.).

<sup>82</sup> *Id.* § 571(7).

‘[I]n confidence’ means, with respect to information, that the information is provided--(A) with the expressed intent of the source that it not be disclosed; or (B) under circumstances that would create the reasonable expectation on behalf of the source that the information will not be disclosed.

*Id.*

<sup>83</sup> *Id.* § 574(a)(1).

Except as provided in subsections (d) and (e), a neutral in a dispute resolution proceeding shall not voluntarily disclose or through discovery or compulsory process be required to disclose any dispute resolution communication or any communication provided in confidence to the neutral, unless-- (1) all parties to the dispute resolution proceeding and the neutral consent in writing, and, if the dispute resolution communication was provided by a nonparty participant, that participant also consents in writing.

*Id.*

<sup>84</sup> *Id.* § 574(a)(2)(“[T]he dispute resolution communication has already been made public . . .”).

<sup>85</sup> *Id.* § 574(a)(3)(“[T]he dispute resolution communication is required by statute to be made public, but a neutral should make such communication public only if no other person is reasonably available to disclose the communication.”).

<sup>86</sup> *Id.* § 574(a)(4).

[A] court determines that such testimony or disclosure is necessary to-- (A) prevent a manifest in justice; (B) help establish a violation of law; or (C) prevent harm to the public health or safety, of sufficient magnitude in the particular case to outweigh the integrity of dispute resolution proceedings in general by reducing the confidence of parties in future cases that their communications will remain confidential.

*Id.*



## 2. Disclosure by a Party Under the ADRA

Under the ADRA, a neutral cannot disclose any dispute resolution communication or any communication provided to them in confidence.<sup>87</sup> The statute is significantly different for disclosures by a party; the confidentiality protections are much more narrow. The ADRA prohibits a party from voluntarily disclosing, or being required to disclose, through discovery or compulsory process, “dispute resolution communications.”<sup>88</sup> This protection is far different than the protection covering disclosure by a neutral. When the confidence is held by a neutral, the statutory protection involves “dispute resolution communications” and “communications provided in confidence.”<sup>89</sup> When the confidence is held by a party, the statutory language, “communications provided in confidence,” is starkly absent. The significance of the absent language is compounded by an enumerated exception under the ADRA which actually allows the disclosure of confidences by a party to a party.

There are, in fact, several enumerated exceptions under subsection (b) (which focuses on disclosures by a party) and they are similar to those found in subsection (a) (which focuses on disclosures by a neutral). First, a party may disclose confidential communications if they are the party who originally prepared the communication.<sup>90</sup> Second, a party may also disclose the communications if all parties to the ADR consent in writing.<sup>91</sup> Third, a party may disclose information if the communication has already been made public.<sup>92</sup> As with the exception pertaining to neutrals (under subsection (a)), this exception is similarly broad and would cover intentional as well as inadvertent disclosures. Fourth, a party may disclose confidential information if required by statute.<sup>93</sup> The fifth exception concerning parties is the same as the exception for neutrals in subsection (a)(4). A party may disclose confidential communications if a court determines it necessary to prevent a manifest injustice; establish a crime; or if it prevents harm to public health or safety.<sup>94</sup> The sixth exception allows disclosure to serve as parole evidence in

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<sup>87</sup> *Id.* § 574(a).

<sup>88</sup> *Id.* § 574(b)(“A party to a dispute resolution proceeding shall not voluntarily disclose or through discovery or compulsory process be required to disclose any dispute resolution communication. . . .”)

<sup>89</sup> *Id.* § 574(a).

<sup>90</sup> *Id.* § 574(b)(1)(“[T]he communication was prepared by the party seeking disclosure . . .”).

<sup>91</sup> *Id.* § 574(b)(2)(“[A]ll parties to the dispute resolution proceeding consent in writing . . .”).

<sup>92</sup> *Id.* § 574(b)(3)(“[T]he dispute resolution communication has already been made public . . .”).

<sup>93</sup> *Id.* § 574(b)(4)(“[T]he dispute resolution communication is required by statute to be made public . . .”).

<sup>94</sup> *Id.* § 574(b)(5).

[A] court determines that such testimony or disclosure is necessary to  
(A) prevent manifest injustice; (B) help establish a violation of law; or

the event there is a dispute over the meaning of an agreement or an award.<sup>95</sup> The last exception, “(b)(7)”, is the most striking and the most troubling,<sup>96</sup> requiring additional explanation.

Section 574(b)(7) (the last exception regarding disclosures by parties) of the ADRA permits disclosure of any kind of dispute resolution communication if it was provided to or was available to all the parties and the neutral did not generate it.<sup>97</sup> In other words, if the communication did not originate with the neutral and, instead, was made by one party to the other party, it has absolutely no confidentiality. This is apparently the reason why the statutory language, “communications provided in confidence” is absent from this portion of the statute.<sup>98</sup> There simply is no confidentiality for any communication between parties. Two parties may intend complete confidentiality in their discussions and communications may be “provided in confidence” to one another—even with the neutral present—but the intent of the parties is irrelevant, the communications are discoverable.

The ADRA provides some protection to communications that are intended to be confidential, but the exceptions of the ADRA create both large loopholes and disparate results. Communications to the neutral third party, who has no interest in the outcome, have more protection than those directly between the parties. In fact, the parties have absolutely no protection for confidences shared between or among themselves. Notably, too, the Act is confusing regarding who makes the determination of whether or not an exception to confidentiality exists at all. While the ADRA has the potential to provide a greater defense of confidentiality, it would have to be amended to provide substantial confidentiality protections.

## VI. IMPROVING CONFIDENCE BY AMENDING THE ADRA

For ADR in Air Force procurement to work, the process needs to keep confidential communications confidential.<sup>99</sup> The ADR process necessarily encompasses a plethora of admissions, closely-held ideas, sensitive strategies,

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(C) prevent harm to the public health and safety, of sufficient magnitude in the particular case to outweigh the integrity of dispute resolution proceedings in general by reducing the confidence of parties in future cases that their communications will remain confidential.

*Id.*

<sup>95</sup> *Id.* § 574(b)(6)(“[T]he dispute resolution communication is relevant to determining the existence or meaning of an agreement or award that resulted from the dispute resolution proceeding or to the enforcement of such an agreement or award . . .”).

<sup>96</sup> *Id.* § 574(b)(7)(“[E]xcept for dispute resolution communications generated by the neutral, the dispute resolution communication was provided to or was available to all parties to the dispute resolution proceeding.”).

<sup>97</sup> *Id.*

<sup>98</sup> 5 U.S.C. § 574(b).

<sup>99</sup> See discussion *supra* Parts II and IV.

and other “inside” information.<sup>100</sup> For the most part, ADR in Air Force procurement relies upon the protections of Rule 408, the ADRA, restraint, and corporate level agreements, to keep individuals from trying to collect such inside information for competitive purposes.

The current legal protections of ADR confidentiality in Air Force procurement must be improved. As it stands, parties to ADR and outside third parties can effectively derail ADR confidentiality protections with little effort, without any violations of the law.<sup>101</sup> Rule 408 and its paper tiger protections provide little security during discovery,<sup>102</sup> and the ADRA, while incredibly detailed, contains a veritable smorgasbord of exceptions.<sup>103</sup> If ADR in Air Force procurement, and the players involved in it seem to be enjoying a type of honeymoon existence,<sup>104</sup> then a single indiscretion involving confidentiality could disrupt its bright and seemingly limitless future.

One could argue that the ADRA needs a mechanism so that the protections it does have are enforceable. Currently, the sole remedy provided in the ADRA for breached confidentiality is reflected in subparagraph (c),<sup>105</sup> which states, “Any dispute resolution communication that is disclosed in violation of subsection (a) or (b), shall not be admissible in any proceeding relating to the issues in controversy with respect to which the communication was made.”<sup>106</sup> This remedy is redundant as Rule 408 already excludes evidence of compromise negotiations.

Moreover, since the ADRA already provides a number of well-pronounced exceptions whereby confidences can be lawfully discovered without violating the ADRA,<sup>107</sup> creating additional enforcement mechanisms while such glaring loopholes exist would be superfluous. Furthermore, the federal rules of civil procedure already provide an adequate number of civil remedies for violating discovery rules and for party misconduct.<sup>108</sup> Hence, the

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<sup>100</sup> Lodge, *Comment: Legislation Protecting Confidentiality in Mediation: Armor of Steel or Eggshells?*, 41 SANTA CLARA L. REV. 1093, 1112 (2001).

<sup>101</sup> See discussion *supra* Part V.

<sup>102</sup> See discussion *supra* Part IV.A.

<sup>103</sup> See discussion *supra* Part V.B.

<sup>104</sup> Interview with Major Karen White, Professor, Contract and Fiscal Law Department, The Judge Advocate General’s School, in Charlottesville, Va. (Jan. 14, 2002).

<sup>105</sup> 5 U.S.C. § 574(c) (2000).

<sup>106</sup> *Id.*

<sup>107</sup> There do not appear to be any continuous violations of any particular portion of the ADRA to defend against or enforce against. Senger, *supra* note 13, at 95.

<sup>108</sup> There are provisions under other federal statutes that offer a litany of enforcement mechanisms.

In a judicial setting, the Federal Rules of Civil Procedure authorize courts to impose sanctions against an attorney or party under Rule 11 for harassing and frivolous conduct in pleadings or representations to the court; under Rule 37 for misconduct in discovery; and under Rule 16 for misconduct or bad faith in the conduct of pretrial conferences and settlement negotiations.

Weston, *supra* note 69, at 607 (citations omitted).

best way to improve the confidentiality protections of ADR is to improve the protections of the ADRA itself.

The ADRA serves as the backbone for Air Force procurement ADR.<sup>109</sup> It establishes a single, uniform rule for all participants to follow, and, if it is strengthened, Air Force procurement ADR will grow stronger as well.<sup>110</sup> The focus of the following discussion is to suggest ways of making the ADRA's protections more precise and less susceptible to confusion or abuse. Proposed statutory changes are laid out in Appendix B.

### **A. Protect Conduct During ADR from Disclosure (5 U.S.C. § 571)**

Subparagraphs (a) and (b) protect dispute resolution communications made to the neutral.<sup>111</sup> However, under § 571, those dispute resolution communications must be oral or written communications prepared for the purpose of ADR.<sup>112</sup> Conduct that occurs during ADR is not included within the definition of a dispute resolution communication.<sup>113</sup> Thus, it would appear from subparagraphs (a) and (b) that one could discover, from a neutral or a party, the conduct of a particular party during ADR. Conduct could include outrage, acts of accommodation, and even a simple admission by silence.<sup>114</sup>

Consider, the following hypothetical cross-examination vignette of the mediator (Mr. Secretz) by counsel for Dojoro Construction wherein the focus is on the conduct exhibited by the contracting officer (Mr. Ko) during the ADR session. The vignette would undoubtedly be the subject of a great amount of motion practice, but the academic point is that conduct during negotiations is unprotected and not a single cross-examination question will require the witness to discuss protected, verbal communications.

Q: Mr. Secretz were you the mediator between the Air Force and Dojoro Construction?

A: Yes, I was.

Q: Did you have private meetings with each party?

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<sup>109</sup> See discussion *supra* Part II.

<sup>110</sup> Strengthening the ADRA is not the only way to improve the future of ADR. ADR participants can seek to strengthen ADR in general by agreeing, amongst themselves, to abide by more effective, uniform confidentiality rules. Their agreement can be memorialized in the ADR agreement (*see* discussion *supra* Part III.B.) or in the procurement contract (*see* discussion *infra*, Part VII). However, strengthening the ADRA, rather than simply agreeing to new confidentiality rules, is a more effective action because the ADRA applies to all individuals, while agreements apply only to signatories. ADRA changes would apply to both the contracting parties and to unsuccessful offerors who may seek to breach confidentiality. See discussion *infra* Part VII.

<sup>111</sup> 5 U.S.C. § 574(a) and (b).

<sup>112</sup> *Id.*

<sup>113</sup> *Id.*

<sup>114</sup> MCCORMICK ON EVIDENCE 648-53 (John William Strong, et al. eds) (1992).

A: Yes, I did.  
Q: With whom did you meet first?  
A: I met with the president of Dojoro Construction.  
Q: Why did you want to meet with him first?  
A: I wanted to hear the contractor's side of the story and to find out why he thought he'd been wronged.  
Q: How long was this meeting with the president?  
A: A few hours.  
Q: I don't want to know what was said, but as a result of this meeting, did you feel you understood Dojoro Construction's concerns?  
A: Absolutely.  
Q: Then you met with the contracting officer?  
A: Yes, Mr. Ko was his name.  
Q: How long after meeting with the president of the Dojoro Construction was this second meeting held?  
A: The next day.  
Q: When you met with Mr. Ko, who spoke first?  
A: I did.  
Q: How long did you personally speak for?  
A: Roughly twenty to thirty uninterrupted minutes.  
Q: I don't want you to tell me what was said but listen to my question. Let's go through this chain of events: after you met with the president of Dojoro Construction, after you sought to learn why he thought he'd been wronged, after you then met with Mr. Ko the following day, after you took the lead, and after you started talking, what did Mr. Ko do during those 20-30 uninterrupted minutes?  
A: What did he say?  
Q: No, what did he DO while you were talking?  
A: Well, after the first five minutes he kinda gasped, his eyes bulged out, his face turned red, and then he sighed and dropped his head. He held his head in his hands for about a minute or two and then he just sat there and nodded as I continued talking.  
Q: How would you describe his demeanor?  
A: Shaken.

Sometimes actions speak louder than words. In the above scenario, the conduct of the contracting officer (Mr. Ko) illustrates fault with alarming clarity. Unquestionably, counsel for the contractor (Dojoro Construction) will argue that the contracting officer's actions demonstrate a complete admission of fault, and he never once had to ask the mediator what the contracting officer said during ADR. The proscriptions of the ADRA were followed, yet confidentiality was trampled.

The drafters of subsection (a) and (b) have created an avenue through which ADR confidences can be breached. Rule 408 specifically excludes the

admissibility of statements and conduct made in compromise negotiations;<sup>115</sup> the ADRA should mirror Rule 408 on this issue, and should include a similar sweeping provision. To this end, the ADRA definition of “dispute resolution communication”<sup>116</sup> should be expanded to include conduct as well as statements. Consequently, it would be a more effective second line of defense for confidentiality.<sup>117</sup>

### **B. Protect Unauthorized Disclosure of Matters That Have Already Been Made Public (5 U.S.C. § 574(a)(2) and (b)(2))**

The second exception to subsection (a) and the third exception to subsection (b) address communications that have already been disclosed to the public.<sup>118</sup> Specifically, they permit releasing communications that have “already been made public.”<sup>119</sup> The rule has a logical premise: there is no need to protect matters already common knowledge. It’s a simple concept that permits potentially secret matters to remain protected while allowing shared information to continue to be shared.

The problem with the exception is that it unwittingly encourages repeated violations of confidentiality. Subsection (a)(2) and (b)(3) provide that once a communication has been made public—intentionally or unintentionally, advertently or inadvertently—confidentiality may be breached.<sup>120</sup> If, for example, a party to ADR mistakenly or purposefully releases confidential materials to the public, then those matters lose all future protection because they have “already been made public.”<sup>121</sup>

Consider the following fictional cross-examination of the contracting officer (Mr. Ko) by counsel for Dojoro Construction about confidential matters accidentally made public.

Q: Mr. Ko you are a contracting officer for the Air Force?

A: Yes, I am indeed.

Q: And you were engaged in ADR with Dojoro Construction a few months ago?

A: That’s correct.

Q: And in preparation for that ADR, you put together a report that you planned to share with the mediator, Mr. Secretz?

A: I’m not at liberty to discuss that. Those matters are confidential.

Q: I see. Mr. Smith did you lose a briefcase a few months ago?

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<sup>115</sup> FED. R. EVID. 408.

<sup>116</sup> 5 U.S.C. § 571.

<sup>117</sup> See *infra* Appendix B.

<sup>118</sup> 5 U.S.C. § 574(a)(2) and (b)(3).

<sup>119</sup> *Id.*

<sup>120</sup> *Id.*

<sup>121</sup> *Id.*

A: Why yes, at the very time I was engaged in ADR with Dojoro.  
Q: Did you get it back?  
A: No.  
Q: Did you expect to get it back?  
A: Sure. Anyone looking inside the briefcase would have found my name and address.  
Q: So obviously you expected someone to have read through the papers in your briefcase in the event they found it?  
A: ...um, well, they wouldn't have to read everything in the briefcase.  
Q: Do you see where we're going?  
A: Yeah, and I don't think I wanna go there.  
Q: I'm showing you an exhibit, and I'd like to ask you if it looks anything like the ADR report you had in your briefcase a few months ago?  
A: That's confidential; it was prepared for the mediator's eyes only!  
Q: You do understand that by losing your briefcase, you forced folks to look inside of it for identification, and as a result, this report was, shall we say, "made public?"  
A: I didn't tell them to read my case files.  
Q: No, but you inadvertently made them public didn't you?

Confidential matters can be made public through many different means that are inadvertent or unintentional (and advertent and intentional as well). Reports prepared for ADR can be left behind on planes or lunchrooms. Private conversations about confidential communications can be overheard at a golf course, on a public phone, or in a locker room.

ADRA exceptions, as written, do not allow anyone to "unring the bell" once any matter has been made public. Instead, once a confidential communication has been made public, confidentiality protections under the ADRA are permanently eliminated. Subsections (a)(2) and (b)(3) need to be amended to maintain confidentiality despite unauthorized releases.<sup>122</sup>

### **C. Create Confidentiality for Disclosures Between Parties (5 U.S.C. § 574(b)(7))**

As discussed above, subsection (b)(7) limits confidentiality between parties; in fact, there is no confidentiality between them under the ADRA.<sup>123</sup> As a result, parties who engage in direct or indirect communication cannot expect any confidentiality.<sup>124</sup> Even discussions between parties during a joint

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<sup>122</sup> See *infra* Appendix B.

<sup>123</sup> See discussion *supra* Part V.B.1.

<sup>124</sup> 5 U.S.C. § 574(b)(7).

session are unprotected.<sup>125</sup> (On the other hand, virtually everything the neutral discusses during the joint session is automatically protected.<sup>126</sup>)

The inability of parties to directly engage one another in protected discussions is in head-on collision with the fact that ADR necessarily involves an exchange of ideas between the parties. “The parties haggle, talk, and listen, proposing any idea that comes to mind until a workable resolution begins to gel. For that to happen, all parties must share information openly.”<sup>127</sup> It is no wonder the Administrative Conference of the United States—which evaluated ADR in government before the reauthorization of the ADRA—reported to Congress that subsection (b)(7) should be eliminated.<sup>128</sup>

A practical review of the confidentiality weaknesses created by (b)(7) reveals confusing results. For example, after ADR discussions have begun, a conscientious contractor seeking quick resolution, unilaterally prepares a report detailing which concerns he is prepared to forfeit and which are non-negotiable, giving one copy of the report to the neutral and a second copy to the opposing party. The first copy to the neutral is supposed to receive confidential protections, but the second copy to the opposing party receives none. If the neutral hands the first copy of the report over to the opposing party, the first copy supposedly remains confidential while the second copy still has no confidentiality—even though they are both in the hands of the same individual. Subsection (b)(7) seemingly allows a neutral third party to apply his or her “Midas touch” to the report, rendering it suddenly confidential. This makes no sense.

The confusion becomes mind numbing when you add the exception of subsection (a)(2)<sup>129</sup> to the exception in (b)(7). Imagine the same scenario wherein a contractor provides the first copy of an ADR report to a neutral and a second copy to the opposing party. As mentioned above, the first copy of the ADR report to the neutral is supposed to be confidential, while the second copy is unprotected. Imagine now that an outsider enters the scenario and demands that the neutral turn over the first copy of the ADR report. Naturally, the neutral will want to deny the discovery request, but since the second copy of the report has already been provided to the opposing party under (b)(7), it has now been “made public” under (a)(2) and lost its confidentiality protections.<sup>130</sup> In short, the unprotected nature of the second report causes the first—seemingly protected—report to lose its confidential protections. The

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<sup>125</sup> *Id.*

<sup>126</sup> *Id.* § 574(a).

<sup>127</sup> Lodge, *supra* note 100, at 1112.

<sup>128</sup> ADMINISTRATIVE CONFERENCE OF THE UNITED STATES, REPORT ON AGENCY IMPLEMENTATION OF THE ADMINISTRATIVE DISPUTE RESOLUTION ACT, SUBJECT: TOWARD IMPROVED AGENCY DISPUTE RESOLUTION: IMPLEMENTING THE ADR ACT (Feb. 1995)[hereinafter ADMINISTRATIVE CONFERENCE REPORT].

<sup>129</sup> The exception of 5 U.S.C. § 574(a)(2) eliminates confidentiality if “the dispute resolution has already been made public.” *Id.*

<sup>130</sup> *Id.*



neutral will be hard pressed to legally deny the discovery request under the ADRA. The recommendation of the Administrative Conference of the United States should be implemented, and (b)(7) should be eliminated.<sup>131</sup>

#### **D. Establish a Disclosure Process for Parties (5 U.S.C. § 574(e))**

The provisions of the ADRA provide a limited process whereby a participant can make a disclosure of confidential information. Disclosure may occur if a court determines that communications must be provided to prevent manifest injustice, establish a crime, or prevent harm to the public health or safety.<sup>132</sup> Additionally, disclosure may occur if a neutral gives proper notice to the parties involved. Unfortunately, the ADRA is silent on the processes or procedures that must be followed if a party wants to, or needs to make a proper disclosure.

There are times when the disclosure of confidential matters is proper. For instance, exception (h) permits the disclosure of dispute resolution communications if the requestor is gathering the information for research or governmental purposes.<sup>133</sup> Unfortunately, there are no consistent guidelines establishing how disclosure should occur. If the educational request is presented to a neutral, the neutral must notify the participating parties before release; however, if the request is presented to a party, there are no notification procedures required at all.<sup>134</sup>

There is no rhyme or reason to explain this disparity in release procedures. As a result, parties are left to determine on their own whether an opposing party might have an objection to the release of confidential matters. Moreover, it is entirely left to the parties to determine whether they even want to notify the opposing party that an outsider is seeking confidential matters. Failure to provide consistent guidance on how parties can or cannot release confidential information provides more fertile ground for confusion and/or

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<sup>131</sup> ADMINISTRATIVE CONFERENCE REPORT *supra* note 128. *See infra* Appendix B (5 U.S.C. § 574(j) would also have to be expanded to make confidential communications between the parties exempt from FOIA).

<sup>132</sup> 5 U.S.C. § 574(a)(4), (b)(5) (2000).

<sup>133</sup> *Id.* § 574(h) (“Subsections (a) and (b) shall not prevent the gathering of information for research or educational purposes, in cooperation with other agencies, governmental entities, or dispute resolution programs, so long as the parties and the specific issues in controversy are not identifiable.”).

<sup>134</sup> *Id.* § 574(e).

(e) If a demand for disclosure, by way of discovery request or other legal process, is made upon a neutral regarding a dispute resolution communication, the neutral shall make reasonable efforts to notify the parties and any affected nonparty participants of the demand. Any party or affected nonparty participant who receives such notice and within 15 calendar days does not offer to defend a refusal of the neutral to disclose the requested information shall have waived any objection to such disclosure.

*Id.*

abuse. The ADRA should be amended to provide parties with the same disclosure procedures that neutrals currently have to follow; the amendment would be simple and helpful.<sup>135</sup>

## VII. Improving Confidence Through Changes in the FAR

Practically speaking, it does not appear as if the ADRA will be amended anytime soon, but the Air Force is not helpless in this regard. Expedient amendments to confidentiality protections are available through an alternate means. Confidentiality protections can be improved through contract provisions. Federal guidance recommends the use of a contract to protect confidentiality between parties.

The Council does recognize that these provisions could hinder a party's candor in a joint session, and therefore the Guidance suggests that parties address this issue through the use of a contract. Confidentiality agreements are a standard practice in many ADR contexts, and their use is encouraged in Federal dispute resolution processes where confidentiality of party-to-party communication is desired.<sup>136</sup>

Contract language can be drafted to close a number of the loopholes created by Rule 408<sup>137</sup> and the ADRA.<sup>138</sup> As discussed above, some major contractors already sign ADR agreements with the Air Force,<sup>139</sup> but these agreements do not apply universally. Contract language that strengthens confidentiality could apply to all contractors who deal with the Air Force through the use of a supplemented FAR, D[efense]FAR or A[ir]F[orce]FAR provision.

The use of a contract clause to make the ADRA more effective is entirely consistent with the communication proscriptions of the ADRA.

The ADRA provides that parties may agree to alternative confidential procedures for disclosures by a neutral. While there is no parallel provision for parties, the exclusive wording of this subsection should not be construed as limiting parties' ability to agree to alternative confidentiality procedures. Parties have a general right to sign confidentiality agreements and there is no reason this should change in a mediation context.<sup>140</sup>

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<sup>135</sup> See *infra* Appendix B.

<sup>136</sup> Confidentiality in Federal Alternative Dispute Resolution Programs, 65 Fed. Reg. 83,085-87 (Dec. 29, 2000) (Guidance).

<sup>137</sup> See discussion *supra* Part V.A.

<sup>138</sup> See discussion *supra* Part V.B.

<sup>139</sup> See discussion *supra* Part III.B.

<sup>140</sup> Confidentiality in Federal Alternative Dispute Resolution Programs, 65 Fed. Reg. 83,085, 83093 (Dec. 29, 2000) (Guidance).

The content of separate confidentiality agreements is extremely flexible. “Parties may agree to more, or less, confidentiality for disclosure by the neutral or themselves than is provided for in the Act.”<sup>141</sup>

Alternative dispute resolution and confidentiality are not foreign concepts to the FAR. The FAR provides—like the ADRA—for the use of ADR and for the use of supplemental ADR procedures in Part 33.214.<sup>142</sup> Under FAR Part 33.214, there are four essential elements for ADR:

- (1) Existence of an issue in controversy;
- (2) A voluntary election by both parties to participate in the ADR process;
- (3) An agreement on alternative procedures and terms to be used in lieu of formal litigation; and
- (4) Participation in the process by officials of both parties who have the authority to resolve the issue in controversy.<sup>143</sup>

This clause also refers to confidentiality. It states, “[t]he confidentiality of ADR proceedings shall be protected consistent with 5 U.S.C. 574 [the ADRA].”<sup>144</sup>

The FAR even defines a neutral,<sup>145</sup> stating that “a neutral person may be used to facilitate resolution of the issue in controversy using the *procedures chosen by the parties* (emphasis added).”<sup>146</sup> The ADRA needs to be supplemented, and FAR Part 33.214 is written to help meet that need by authorizing supplemental procedures to accomplish that task.

An amended FAR clause (*i.e.* FAR Part 33.214) improving confidentiality should address the same ADRA weaknesses identified in the immediately preceding section.<sup>147</sup> As is evident from the proposed amendments at Appendix C, an amended FAR Part 33.214 would follow the same framework as the ADRA.

Understandably, any contract provisions affecting confidentiality could only be enforceable against contract signatories. Confidentiality contract provisions would not apply to third parties attempting to discover ADR negotiations, but such a limitation should not prevent the strengthening of ADR confidentiality through the FAR. Confidentiality contract provisions would still improve confidentiality between the participants and allow protections to progress beyond their current, limited status. Promises of

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<sup>141</sup> *Id.*

<sup>142</sup> FAR, *supra* note 6, at 33.214.

<sup>143</sup> *Id.*

<sup>144</sup> FAR, *supra* note 6, at 33.214(e).

<sup>145</sup> FAR, *supra* note 6, at 33.214(d).

<sup>146</sup> *Id.* (“When appropriate, a neutral person may be used to facilitate resolution of the issue in controversy using the procedures chosen by the parties.”).

<sup>147</sup> See discussion *supra* Parts VI.A-E.

confidentiality must be promoted if the promise of ADR in Air Force procurement is to be fully realized.<sup>148</sup>

## VIII. CONCLUSION

The Air Force has recognized that litigation is frequently too costly: it is financially expensive,<sup>149</sup> risky,<sup>150</sup> and time-consuming.<sup>151</sup> On the other hand, ADR provides a more “palatable environment for parties to resolve their differences.”<sup>152</sup> The Air Force has embraced ADR, and its leadership is actively promoting it.<sup>153</sup> Early successes in ADR have resulted in its use being mandated to the maximum extent practicable,<sup>154</sup> and, such use in the Air Force has been bountifully rewarded in the world of procurement.<sup>155</sup> Cases are being resolved more quickly, and billions of dollars are being saved.<sup>156</sup> Accordingly, it would seem that alternative dispute resolution should have a bright future in Air Force procurement.

Nonetheless, litigation continues to be a fact of life in conducting the ongoing sizeable business of the modern Air Force. Some cases are not right for ADR, and litigation may be the only means to resolve them.<sup>157</sup> Effective litigators endeavor to win, capitalizing on strengths and concomitantly exploiting weaknesses. In the alternative dispute resolution process, the most significant weakness is its limited confidentiality protections.<sup>158</sup>

Litigators—or contractors with a litigation mindset—can exploit ADR’s confidentiality weaknesses. When there is a lot of money at issue, there can be great temptation to seek ADR information.<sup>159</sup> Litigators can certainly be lured into trying to gain an advantage by piercing the confidentiality of ADR.<sup>160</sup> They may have a weak case, they may suspect wrongdoing, or they may just desire victory; after all, there is no shame in representing a client zealously. Regardless, under Rule 408 and the ADRA, litigators can discover confidential matters through numerous lawful means.<sup>161</sup>

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<sup>148</sup> See discussion *supra* Part III.A.

<sup>149</sup> Marksteiner, *supra* note 54, at 91-92.

<sup>150</sup> Senger, *supra* note 13, at 90.

<sup>151</sup> Kentra, *supra* note 3, at 721.

<sup>152</sup> Weston, *supra* note 69, at 594.

<sup>153</sup> See discussion *supra* Part III.A.

<sup>154</sup> AF ADR Policy Letter, *supra* note 32.

<sup>155</sup> See discussion *supra* Part III.A.

<sup>156</sup> AF ADR Policy Letter, *supra* note 32.

<sup>157</sup> 5 Year Plan, *supra* note 44, at 1; Senger, *supra* note 13, at 93 (“While we do not argue that ADR is appropriate in every case, situations where we recommend against it are rare, such as when the government needs a court ruling for a public sanction or a legal precedent.”) (citation omitted).

<sup>158</sup> See discussion *supra* Part IV.

<sup>159</sup> *Id.*

<sup>160</sup> Weston, *supra* note 69, at 595.

<sup>161</sup> See discussion *supra* Part V.

Alternative dispute resolution is successful because litigation can be extraordinarily taxing on the parties.<sup>162</sup> Nonetheless, alternative dispute resolution's popularity will undoubtedly diminish if litigators are able to use it as a discovery vehicle. Some parties will be less forthcoming in their negotiations and others may stay away from it entirely.<sup>163</sup> If parties have no confidence in confidentiality, they will have little or no confidence in the use of ADR.<sup>164</sup> In this regard, the future of ADR is contingent upon the effectiveness of ADR's confidentiality protections, and, at present, those protections are not particularly effective.<sup>165</sup>

Confidentiality must be improved. The ADRA must be amended, or, in the alternative, a contract clause should be developed and added to protect the confidentiality of ADR communications between participants and allow them to engage in a collegial exchange of ideas without worrying about who generated the discussion and who can legally discover the contents of the discussion.<sup>166</sup> If prompt resolution of issues can be expected without having to resort to litigation, there must be confidence that ADR confidential communications will be kept confidential. This can only occur with adequate legal protections. Until such protections are in effect, the long-term success of ADR remains in doubt.

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<sup>162</sup> Marksteiner, *supra* note 54, at 91-92; Senger, *supra* note 13, at 90; Kentra, *supra* note 3, at 721; Weston, *supra* note 69, at 594.

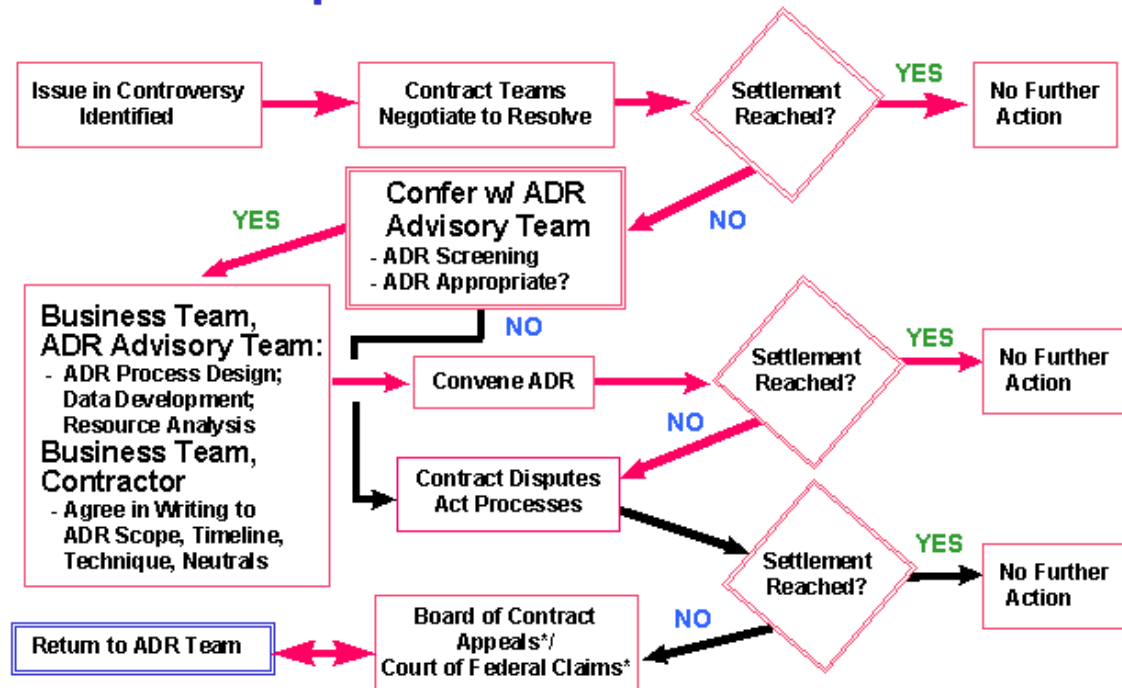
<sup>163</sup> See discussion *supra* Part IV.

<sup>164</sup> *Id.*

<sup>165</sup> See discussion *supra* Part V.

<sup>166</sup> Confidentiality in Federal Alternative Dispute Resolution Programs, 65 Fed. Reg. 83,085 (Dec. 29, 2000) (*Guidance*).

## Alternative Dispute Resolution Model



\*\* 5 Year Plan, *supra* note 44.

## Appendix B

### Proposed Changes to the ADRA<sup>\*\*\*</sup>

#### § 571. Definitions

For the purposes of this subchapter [5 USCS §§ 571 et seq.], the term--

- (1) "agency" has the same meaning as in section 551(1) of this title;
- (2) "administrative program" includes a Federal function which involves protection of the public interest and the determination of rights, privileges, and obligations of private persons through rule making, adjudication, licensing, or investigation, as those terms are used in subchapter II of this chapter [5 USCS §§ 551 et seq.];
- (3) "alternative means of dispute resolution" means any procedure that is used to resolve issues in controversy, including, but not limited to, conciliation, facilitation, mediation, factfinding, minitrials, arbitration, and use of ombuds, or any combination thereof;
- (4) "award" means any decision by an arbitrator resolving the issues in controversy;
- (5) "dispute resolution communication" means any oral or written communication prepared for the purposes of, *or conduct made in*, a dispute resolution proceeding, including any memoranda, notes or work product of the neutral, parties or nonparty participant; except that a written agreement to enter into a dispute resolution proceeding, or final written agreement or arbitral award reached as a result of a dispute resolution proceeding, is not a dispute resolution communication;
- (6) "dispute resolution proceeding" means any process in which an alternative means of dispute resolution is used to resolve an issue in controversy in which a neutral is appointed and specified parties participate;
- (7) "in confidence" means, with respect to information, that the information is provided--
  - (A) with the expressed intent of the source that it not be disclosed; or
  - (B) under circumstances that would create the reasonable expectation on behalf of the source that the information will not be disclosed;
- (8) "issue in controversy" means an issue which is material to a decision concerning an administrative program of an agency, and with which there is disagreement--
  - (A) between an agency and persons who would be substantially affected by the decision; or
  - (B) between persons who would be substantially affected by the decision;
- (9) "neutral" means an individual who, with respect to an issue in controversy, functions specifically to aid the parties in resolving the controversy;
- (10) "party" means--
  - (A) for a proceeding with named parties, the same as in section 551(3) of this title; and
  - (B) for a proceeding without named parties, a person who will be significantly affected by the decision in the proceeding and who participates in the proceeding;
- (11) "person" has the same meaning as in section 551(2) of this title; and

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\*\*\* Proposed additions to the ADRA appear in bold italics (e.g. *proposed addition*). Proposed deletions from the ADRA appear in strike-through ~~proposed deletions~~.

(12) "roster" means a list of persons qualified to provide services as neutrals.

§ 574. Confidentiality

(a) Except as provided in subsections (d) and (e), a neutral in a dispute resolution proceeding shall not voluntarily disclose or through discovery or compulsory process be required to disclose any dispute resolution communication or any communication provided in confidence to the neutral, unless--

(1) all parties to the dispute resolution proceeding and the neutral consent in writing, and, if the dispute resolution communication was provided by a nonparty participant, that participant also consents in writing;

(2) the dispute resolution communication has already been *intentionally or advertently* made public;

(3) the dispute resolution communication is required by statute to be made public, but a neutral should make such communication public only if no other person is reasonably available to disclose the communication; or

(4) a court determines that such testimony or disclosure is necessary to--

(A) prevent a manifest injustice;

(B) help establish a violation of law; or

(C) prevent harm to the public health or safety, of sufficient magnitude in the particular case to outweigh the integrity of dispute resolution proceedings in general by reducing the confidence of parties in future cases that their communications will remain confidential.

(b) A party to a dispute resolution proceeding shall not voluntarily disclose or through discovery or compulsory process be required to disclose any dispute resolution communication *or any communication provided in confidence to the party*, unless--

(1) the communication was prepared by the party seeking disclosure;

(2) all parties to the dispute resolution proceeding consent in writing;

(3) the dispute resolution communication has already been *intentionally or advertently* made public;

(4) the dispute resolution communication is required by statute to be made public;

(5) a court determines that such testimony or disclosure is necessary to--

(A) prevent a manifest injustice;

(B) help establish a violation of law; or

(C) prevent harm to the public health and safety,

of sufficient magnitude in the particular case to outweigh the integrity of dispute resolution proceedings in general by reducing the confidence of parties in future cases that their communications will remain confidential;

(6) the dispute resolution communication is relevant to determining the existence or meaning of an agreement or award that resulted from the dispute resolution proceeding or to the enforcement of such an agreement or award; ~~or~~

~~—(7) except for dispute resolution communications generated by the neutral, the dispute resolution communication was provided to or was available to all parties to the dispute resolution proceeding.~~

(c) Any dispute resolution communication that is disclosed in violation of subsection (a) or



(b), shall not be admissible in any proceeding relating to the issues in controversy with respect to which the communication was made.

(d) (1) The parties may agree to alternative confidential procedures for disclosures by a neutral. Upon such agreement the parties shall inform the neutral before the commencement of the dispute resolution proceeding of any modifications to the provisions of subsection (a) that will govern the confidentiality of the dispute resolution proceeding. If the parties do not so inform the neutral, subsection (a) shall apply.

(2) To qualify for the exemption established under subsection (j), an alternative confidential procedure under this subsection may not provide for less disclosure than the confidential procedures otherwise provided under this section.

(e) If a demand for disclosure, by way of discovery request or other legal process, is made upon a neutral *or party* regarding a dispute resolution communication, the neutral *or party* shall make reasonable efforts to notify the parties and any affected nonparty participants of the demand. Any party or affected nonparty participant who receives such notice and within 15 calendar days does not offer to defend a refusal of the neutral *or party* to disclose the requested information shall have waived any objection to such disclosure.

(f) Nothing in this section shall prevent the discovery or admissibility of any evidence that is otherwise discoverable, merely because the evidence was presented in the course of a dispute resolution proceeding.

(g) Subsections (a) and (b) shall have no effect on the information and data that are necessary to document an agreement reached or order issued pursuant to a dispute resolution proceeding.

(h) Subsections (a) and (b) shall not prevent the gathering of information for research or educational purposes, in cooperation with other agencies, governmental entities, or dispute resolution programs, so long as the parties and the specific issues in controversy are not identifiable.

(i) Subsections (a) and (b) shall not prevent use of a dispute resolution communication to resolve a dispute between the neutral in a dispute resolution proceeding and a party to or participant in such proceeding, so long as such dispute resolution communication is disclosed only to the extent necessary to resolve such dispute.

(j) A dispute resolution communication which is between a neutral and a party, *or between a party and a party*, and which may not be disclosed under this section shall also be exempt from disclosure under section 552(b)(3).

## Appendix C

### Proposed Changes to FAR Part 33.214\*\*\*\*

a) The objective of using ADR procedures is to increase the opportunity for relatively inexpensive and expeditious resolution of issues in controversy. Essential elements of ADR include --

- (1) Existence of an issue in controversy;
- (2) A voluntary election by both parties to participate in the ADR process;
- (3) An agreement on alternative procedures and terms to be used in lieu of formal litigation; and
- (4) Participation in the process by officials of both parties who have the authority to resolve the issue in controversy.

(b) If the contracting officer rejects a contractor's request for ADR proceedings, the contracting officer shall provide the contractor a written explanation citing one or more of the conditions in 5 U.S.C. 572(b) or such other specific reasons that ADR procedures are inappropriate for the resolution of the dispute. In any case where a contractor rejects a request of an agency for ADR proceedings, the contractor shall inform the agency in writing of the contractor's specific reasons for rejecting the request.

(c) ADR procedures may be used at any time that the contracting officer has authority to resolve the issue in controversy. If a claim has been submitted, ADR procedures may be applied to all or a portion of the claim. When ADR procedures are used subsequent to the issuance of a contracting officer's final decision, their use does not alter any of the time limitations or procedural requirements for filing an appeal of the contracting officer's final decision and does not constitute a reconsideration of the final decision.

(d) When appropriate, a neutral person may be used to facilitate resolution of the issue in controversy using the procedures chosen by the parties.

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\*\*\*\* Proposed additions to the FAR appear in bold (*e.g.* **proposed addition**). Proposed additions to the FAR that are also proposed additions to the ADRA appear in bold, underlined italics (*e.g.* **proposed addition to the FAR which is also an addition to the ADRA**).

(e) The confidentiality of ADR proceedings shall be protected consistent with 5 U.S.C. §§ 571, 574 except to the extent they (5 U.S.C. §§ 571, 574) are supplemented by the following provisions.

(1) "Dispute resolution communication" means any oral or written communication prepared for the purposes of, or conduct made in, a dispute resolution proceeding, including any memoranda, notes or work product of the neutral, parties or nonparty participant; except that a written agreement to enter into a dispute resolution proceeding, or final written agreement or arbitral award reached as a result of a dispute resolution proceeding, is not a dispute resolution communication.

(2) Except as provided in 5 U.S.C. §574, subsections (d) and (e), a neutral in a dispute resolution proceeding shall not voluntarily disclose or through discovery or compulsory process be required to disclose any dispute resolution communication or any communication provided in confidence to the neutral, unless the dispute resolution communication has already been intentionally or advertently made public.

(3) A party to a dispute resolution proceeding shall not voluntarily disclose or through discovery or compulsory process be required to disclose any dispute resolution communication or any communication provided in confidence to the party, unless--

(a) the dispute resolution communication has already been intentionally or advertently made public, or

(b) the dispute resolution communication is relevant to determining the existence or meaning of an agreement or award that resulted from the dispute resolution proceeding or to the enforcement of such an agreement or award.

(4) If a demand for disclosure, by way of discovery request or other legal process, is made upon a neutral or party regarding a dispute resolution communication, the neutral or party shall make reasonable efforts to notify the parties and any affected nonparty participants of the demand. Any party or affected nonparty participant who receives such notice and within 15 calendar days does not offer to defend a refusal of the neutral or party to disclose the requested information shall have waived any objection to such disclosure. \*\*\*\*\*

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\*\*\*\*\* The parties can agree to expand the rules of confidentiality but they cannot contractually agree to ignore the proscriptions of FOIA. Accordingly, 5 U.S.C. § 574(j) and its amending language, found in Appendix B *supra*, could not be added to a potential FAR clause.

# ANDREW JACKSON AND HIS INDIAN WARS

BOOK REVIEW BY CAPTAIN CHRISTOPHER A. LOVE\*

*“Burn their dwellings-destroy their stock-slay their wives and children, that the very breed may perish.”*<sup>1</sup>

Shawnee Chief Tecumseh to the Creek Indians, 1811

*“[I] think myself justified in laying waste their villages, burning their homes, killing their warriors and leading into Captivity their wives and Children.”*<sup>2</sup>

Andrew Jackson to Tennessee Governor Blount, 1812

The collision of cultures which spawned such rhetoric by American Indians and government officials in the late Eighteenth and early Nineteenth centuries fueled more than heated passions. It sustained the longest series of wars in our nation’s history. Over the course of a generation, between 1789 and 1818, those wars reached a fevered pitch. Their cumulative effects almost extinguished all Native American tribes east of the Mississippi River. Those that did not fall to the musket or the sword were forcibly relocated to the western territories<sup>3</sup> under an official government policy, innocuously termed “Removal.”

In his most recent ode to Andrew Jackson, Professor Robert Remini in the book, *Andrew Jackson and His Indian Wars*, challenges his reader to view the process of Indian Removal as a Nineteenth-century American. He convincingly argues that Removal was a visceral response of both the populace and their leadership to an ever-present Indian threat. Excusing neither the policy nor the means by which it was implemented, Remini paints Removal with a realist’s brush, much as Jackson did throughout his public life. In so doing, Remini offers an honest, meticulously researched, and well-written account of a controversial period of American history.

In Chapter One, Remini graphically portrays the Indian threat by recounting Tecumseh’s impassioned speech to the Creek tribal nation at the

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<sup>1</sup> ROBERT V. REMINI, *ANDREW JACKSON AND HIS INDIAN WARS* 3 (2001).

<sup>2</sup> *Id.* at 57.

<sup>3</sup> *Id.* at 256.

annual tribal grand council of 1811.<sup>4</sup> The viciousness to which the Indians had been pushed by white settler encroachment is palpable in the words of Tecumseh to the assembled Creeks, “Let the white race perish.... Back whence they came, upon a trail of blood, they must be driven!”<sup>5</sup> To maximize the impact of such statements, Remini injects them directly into his narrative text, without introduction or paraphrasing. Although occasionally awkward, this technique of jumping into the first person without notice, grabs the reader’s attention and imagination. The reader can almost envision Remini as the narrator of a documentary film in which each character comes to life in a separate voice. Of course, the most frequent voice is Andrew Jackson’s.

Remini traces Jackson’s perspective on Indian relations from the arrival of his parents in America from Ireland in 1765. Indeed, Remini notes that the Jacksons arrived during a wave of immigration that followed the removal of the Catawba Indians from most of the South Carolina Piedmont<sup>6</sup> in 1761.<sup>7</sup> Notwithstanding the relative safety that was experienced in the area by the white population because of its increasingly large size, owing mainly to the arrival of more immigrants from Europe, Remini explains that Indian attacks from areas west or north of the Piedmont remained a constant source of fear for the new immigrants. Indeed, he cites a contemporary neighbor’s characterization of the Jacksons as “inveterate haters of the Indians” after the murder of one of their “kinsmen.”<sup>8</sup>

Having established a direct nexus of fear and mistrust between Andrew Jackson and the Indians, Remini embarks on a brief journey through the early years of the future U.S. president’s life, from action in the Revolutionary War, to admission to the North Carolina Bar, to appointment as a state prosecutor in the territory that would later become Tennessee. His subsequent appointment as Judge Advocate for the Davidson county militia in 1792 solidified his position within the most important political circles of the burgeoning territory.<sup>9</sup> Notwithstanding its political importance,<sup>10</sup> the position has been described by another historian as not prominent, conferred chiefly because Jackson was a lawyer; but it identified him with a calling for which he was by nature

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<sup>4</sup> *Id.* at 1.

<sup>5</sup> *Id.* at 3.

<sup>6</sup> *Id.* at 9, referring to the upland area, known also as the Waxhaws, which stretched from North to South Carolina.

<sup>7</sup> *Id.* at 11. Following the Cherokee War of 1760-1761.

<sup>8</sup> *Id.* at 14. From the account of a neighbor of the Jackson’s, precisely which member of the family was killed is uncertain, but Remini ascribes significant reliability to the source, Mrs. Susan Alexander, who gave her account in 1845, following the death of Andrew Jackson.

<sup>9</sup> *Id.* at 34.

<sup>10</sup> Although not powerful, the post had enormous potential. With every able-bodied male required to serve, the militia constituted the most extensive institution in the newly settled territory. To the frightened colonists, the militia official, no less than an officer of the law, promised protection against the forces of disorder. JAMES C. CURTIS, *ANDREW JACKSON AND THE SEARCH FOR VINDICATION* 29 (1976).

eminently fitted.<sup>11</sup> Although it served as his entrée to the military establishment, Jackson's tenure as a judge advocate was apparently short-lived.<sup>12</sup>

In the treacherous American Frontier environment, Jackson often took responsibility for protecting groups of settlers traveling between enclaves of safety throughout the territory.<sup>13</sup> According to Remini, Jackson not only assumed, but actively pursued this role.<sup>14</sup> More significant to Jackson than isolated skirmishes with bands of Indians, however, was what he called the "triple headed menace," the looming presence of English, Spanish, and Indian belligerents along the American border.<sup>15</sup> Jackson considered this presence the greatest threat facing the American Frontier and the nation.<sup>16</sup>

England and Spain engaged in covert war against the United States during the late Eighteenth and early Nineteenth centuries by providing frontier Indians with firearms.<sup>17</sup> Indeed, a key element of the British battle plan for the invasion of New Orleans involved the creation of a large Indian buffer zone along the Gulf Coast to protect their advance.<sup>18</sup> The violence facilitated by such foreign intervention prompted settlers to continually petition the new federal government for help. These petitions fell on deaf ears. According to Remini, Washington was more disposed to reimburse the tribes in the East for lands already lost, and to legislate against any further encroachment.<sup>19</sup>

This divergence between federal action and local need gave rise to, or at least perpetuated, what Remini terms the "Spanish Conspiracy," a view to which many white settlers subscribed. They believed that they would receive no protection from Washington against the Indians, and thought that only the nearby Spanish could solve their security problem.

Incredibly, Remini suggests that even Jackson subscribed to this view. Although he cites a Jackson letter threatening to "seek... protection from some other source,"<sup>20</sup> Remini does not explore the lengths to which this perspective might have been an accurate portrayal of Jackson's true sentiment toward his nascent federal government. Rather, the whole of Remini's position on

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<sup>11</sup> JOHN S. BASSETT, *THE LIFE OF ANDREW JACKSON* 26 (1911).

<sup>12</sup> The last entry in Jackson's papers referring to the post is dated November 6, 1793. SAM B. SMITH AND HARRIET C. OWSLEY, *THE PAPERS OF ANDREW JACKSON, VOL. I, 1770-1803* 41 (1980). Presumably, shortly after this entry, he no longer held this position; the historical record is unclear.

<sup>13</sup> REMINI at 26. According to Remini, on average, one settler was lost to Indian attack every ten days.

<sup>14</sup> *Id.* at 29. "The accumulation of such events as these shaped Jackson into a bold and resourceful Indian fighter, thirsting for 'encounters with the savages.'"

<sup>15</sup> *Id.* at 24. Effectively, the Mississippi River Valley from the Canadian border to the 31<sup>st</sup> parallel.

<sup>16</sup> *Id.* at 23.

<sup>17</sup> *Id.* at 24.

<sup>18</sup> *Id.* at 94.

<sup>19</sup> *Id.* at 31.

<sup>20</sup> *Id.* at 33.

Jackson's treatment of the Indians hinges on the depths of Jackson's national security concerns.

The ever-present conflict between frontier exigencies and the direction of official Washington policy remains central to Remini's explanation of Jackson's treatment of the Indians. Jackson's personal involvement in a series of excursions against the Chickamauga Cherokees in 1794 illustrates this conflict quite well.<sup>21</sup> In one of these operations, he accompanied a detachment led by Major James Ore against a number of Indian settlements near Chattanooga. Conducted under a veil of secrecy and counter to express instructions from the Secretary of War to refrain from all offensive action against the Indians, the military expedition was a resounding tactical success. The extensive publicity which resulted, however, forced the commanding general of the militia to resign for disobeying the War Department. Shockingly, when no one would accept appointment in his place, he quietly resumed command.<sup>22</sup> According to Remini, this blatant disregard for central authority fostered in Jackson the belief that he could ignore superior orders regarding Indian affairs when he thought that his course of action was more compelling and more beneficial to frontier settlers.<sup>23</sup> Jackson's subsequent military exploits against the Indians appear to prove Remini correct.

Remini next describes the political jockeying that surrounded Jackson's election to the House of Representatives,<sup>24</sup> the Senate,<sup>25</sup> the Tennessee Bench,<sup>26</sup> and finally, to the position he most sought, Major General of the Tennessee Militia.<sup>27</sup> In his command of the Militia, General Jackson demonstrated keen military intelligence, extraordinary care for his men, and strict impartiality in his enforcement of the terms of Indian treaties.<sup>28</sup> Remini also readily notes that most of the treaties that Jackson was left to enforce were largely contrived land grabs. Indians who purchased goods from government stores on credit were encouraged to enter "treaties" in which they agreed to relinquish land for the cancellation of their debt. Remini makes particular note that President Thomas Jefferson was an eager proponent of this tactic.<sup>29</sup> Unfortunately, Remini directs his readers to a citation that recounts a particular example of the practice, rather than documentary evidence of Mr. Jefferson's position on the practice.

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<sup>21</sup> *Id.* at 34.

<sup>22</sup> *Id.* at 35.

<sup>23</sup> Although Remini does not indicate whether Jackson still held the position of judge advocate at the time, it would likely not have mattered much. As Remini notes, it often seemed "that the general knew no law but his own." *Id.* at 157.

<sup>24</sup> *Id.* at 37.

<sup>25</sup> *Id.* at 43.

<sup>26</sup> *Id.* at 45.

<sup>27</sup> *Id.* at 47. See *id.* at 37 for an explanation of the electoral process within the militia.

<sup>28</sup> *Id.* at 47.

<sup>29</sup> *Id.* at 49.

Having set the stage delineating the multifaceted aspects of Jackson's predilections, Remini next embarks on a chronology of Jackson's military exploits against the Indians, the British, and the Spanish. As Jackson ploddingly hacks away at this "triple headed menace," the reader is faithfully reminded of Jackson's overriding inspiration -- national security -- and the means by which Jackson believed that goal could finally be secured, Indian Removal.

As early as 1809, Jackson corresponded with the governor of Tennessee on the issue of removing the Indians to the Louisiana Territory.<sup>30</sup> Rather than forcing Indians into debt and then cheating them out of their land, the idea of an even exchange was considered a more morally acceptable solution by many frontier officials.<sup>31</sup> Although both men ardently supported Removal, it was an idea whose time had not yet come. The federal government had displayed its preference to enter into treaties with the Indians, and Jackson continued to be their chief enforcer in the territories south of the Ohio River.

In preserving the rule of law on the American Frontier, Jackson was evenly heavy-handed with both white and Indian transgressors. According to Remini, Jackson characterized Indians who broke treaty laws as "renegades" and "half-breeds," as opposed to the "true Indians" who abided by his government's laws.<sup>32</sup> He similarly viewed white squatters on Indian lands as "troublemakers" who risked the safety of all law-abiding frontier people.

However, Remini's own account calls into question the sincerity of Jackson's assertions. White law breakers were delivered to civil authorities for prosecution, and their stock was sold at auction, while a decidedly less judicious end awaited the "renegades" and "half-breeds":

[W]e have sent to demand the murderers, if they are not given up, the whole creek nation shall be covered with blood, fire shall consume their Towns and villages; and their lands shall be divided among the whites.<sup>33</sup>

Following his notorious victory at Horseshoe Bend during the Creek War, Jackson negotiated the Treaty of Fort Jackson. Regarded by Jackson as a shining success, this treaty resulted in the acquisition of over 25 million acres from the Creeks and Cherokees.<sup>34</sup> Ironically, however, Jackson's subsequent victory against the British in the Battle of New Orleans effectively brought an

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<sup>30</sup> *Id.* at 54.

<sup>31</sup> *Id.* at 54. This idea is traced to Thomas Jefferson, yet Remini provides no citation to support this fact.

<sup>32</sup> *Id.* at 56.

<sup>33</sup> *Id.* The force of similar rhetoric echoes still today. See, Walter Russel Mead, *Braced for Jacksonian Ruthlessness*, WASH. POST, Sept. 17, 2001, at A27.

<sup>34</sup> REMINI at 92 (citing the Treaty of Fort Jackson, American State Papers, Indian Affairs, I, 837-38). See, Treaty with the Creeks, 7 Stat. 120 (1814).



end to the War of 1812 and actually put his recent land acquisitions in jeopardy.

The Treaty of Ghent, which ended the War of 1812, contained a provision that obligated the United States to return all Indian land it had acquired since 1811, and to terminate hostilities against all peaceful tribes:<sup>35</sup>

The United States of America engage to put an end immediately after the ratification of the present Treaty to hostilities with all the Tribes or Nations of Indians *with whom they may be at war at the time of such ratification* and forthwith to restore to such Tribes or Nations respectively all the possessions, rights and privileges which they may have enjoyed or been entitled to in one thousand eight hundred and eleven previous to such hostilities.<sup>36</sup>

Remini suggests that this prompted Jackson to have the Tennessee Senators push his treaty, which had been languishing in committee for two months, through to ratification.<sup>37</sup> While noting that the Treaty of Fort Jackson was finally ratified on February 16, 1815, Remini fails to point out that the Treaty of Ghent was then ratified a mere twenty-four hours later.<sup>38</sup> This timing serves only to strengthen Jackson's position that his treaty removed the Creek Nation from the scope of the Treaty of Ghent because it terminated the hostilities between the United States and the Creeks before the Treaty of Ghent was ratified.<sup>39</sup>

Notwithstanding Jackson's eleventh-hour maneuver, the Secretary of War notified him that "conciliatory" action toward the Indians was required by the Treaty of Ghent, and expected by President Madison.<sup>40</sup> Recognizing, however, that such was not in the best interest of "the western people," Jackson sent an armed contingent to escort the surveyors who were plotting the lines contemplated in his treaty.<sup>41</sup> As Remini explains:

Thus with Jackson refusing to honor the provisions of the peace treaty with Great Britain and steadily enforcing his own treaty, with the government unwilling to take any action against a war hero in defense of Indians, and with Britain unable, or unwilling to demand U.S. fulfillment of its promise to return Indian property, the systematic despoilation of the Creek Nation commenced.<sup>42</sup>

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<sup>35</sup> REMINI at 95; United Kingdom Peace and Amity (Treaty of Ghent), 1814 U.S.T. LEXIS 4; 12 Bevens 41.

<sup>36</sup> United Kingdom Peace and Amity (Treaty of Ghent), art IX, 1814 U.S.T. LEXIS 4 [emphasis added]; 12 Bevens 41. Article IX.

<sup>37</sup> REMINI at 95.

<sup>38</sup> *Id.* Remini calls attention to the signing of the Treaty of Ghent in December of 1814, lending the impression that it actually predated the Treaty of Fort Jackson.

<sup>39</sup> See *supra* note 35.

<sup>40</sup> REMINI at 97.

<sup>41</sup> *Id.* at 99.

<sup>42</sup> *Id.* at 99.

The Chickasaws, Choctaws, and Seminoles would soon suffer the same fate, in what Remini accurately characterizes as Jackson's obsession to rid the entire eastern United States of the Indians and replace them with white settlers.<sup>43</sup> Curiously enough, soon after his bold stand against Washington policy, Jackson himself was offered the post of Secretary of War by James Monroe. Perhaps recognizing what little sway that position actually held, Jackson declined the offer and remained in command of the Army of the South.<sup>44</sup>

From this position of power, Jackson continued to methodically seize Indian land, either by military conquest or through adroit negotiation. Remini recounts all the major negotiations in lengthy detail, and shows Jackson to be as ruthless at the table as he was on the battlefield.<sup>45</sup> Undoubtedly, Jackson believed that as more settlers arrived on the frontier from the East, the Removal policy would become more attractive to the Indians. The complexity, however, of implementing removal of many Indians to western regions is epitomized by Remini's account of the military road from Florence, Alabama to the Gulf Coast, near New Orleans, a project championed by Jackson. Again, employing a national defense rationale, Jackson proposed and supported the road as a means to transit troops and supplies quickly between the coast and the interior. Once complete, the road also offered great economic benefits as well. Among those to whom the road brought prosperity were local Indians, who prospered by offering various services at points along its almost 425-mile length. The income derived from this activity provided a powerful incentive for many Indians in the East to resist Removal and loss of this new found fortune.<sup>46</sup>

According to Remini, such complexities infested the implementation of Removal, and predictably wore on Jackson through the years immediately preceding his U.S. presidency. Indeed, the complexities fueled a dispute between the federal government and the states of Georgia, Alabama, and Mississippi which confronted Jackson's presidency in its early days.<sup>47</sup> This dispute accelerated Jackson's introduction of Removal legislation and brought the issue to the forefront of his administration. Even after his Indian Removal Act<sup>48</sup> was passed, however, its terms required Indian removal to western regions as provided by individual treaty, thus spurring another round of lengthy negotiations, too often conducted by unscrupulous state and federal

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<sup>43</sup> *Id.* at 113. "To give to [the south] a strong and permanent settlement of American citizens, competent to its defence."

<sup>44</sup> *Id.* at 117.

<sup>45</sup> *Id.* at 182. The large scope of Jackson's contribution to the land mass of the United States is illustrated graphically on pages 182 and 240.

<sup>46</sup> *Id.* at 188.

<sup>47</sup> *Id.* at 226.

<sup>48</sup> Act of May 28, 1830, ch. 148, 4 Stat. 411.

officials.<sup>49</sup> The implementation of this final phase resulted in the deprivation and suffering that has come to symbolize the American government's treatment of its aboriginal people.

As Remini points out, Jackson's desire to implement Removal with speed and economy ultimately caused great misery.<sup>50</sup> Moreover, the ratification of more than seventy Removal treaties over a period of eight years made oversight virtually impossible.<sup>51</sup> Indeed, Remini asserts that Jackson knew from early experience how futile federal enforcement of Indian treaties had been.<sup>52</sup> Yet his desire for immediate results drove him to enter legally acceptable, but practically worthless, treaties.

Remini's view of this final solution is simple, straightforward, Jacksonian: "Jackson...[forced] Congress to face up to the Indian issue and address it in the only way possible. And what it did at his direction was harsh, arrogant, racist -- and inevitable."<sup>53</sup> Remini ascribes blame to earlier administrations for entering into hollow treaties, while he champions Jackson for dispensing with such machinations and simply doing what had to be done.<sup>54</sup> However, at least one historian, slightly less enamored with Jackson, disagrees:

The government for decades had maintained a dual policy, on the one hand appropriating money for educational purposes and trying to improve living conditions on their present reserves, while at the same time urging them to sell their lands and move westward, out of the way of white settlements. Jackson and his cohorts were determined to shift federal policy toward final and irrevocable removal.<sup>55</sup>

Perhaps then, Removal was merely an alternative, rather than an inevitable, means by which the Indian problem could have been solved.

Regardless of the means, however, the end was inevitable. Set in motion decades before Jackson's presidency, the juggernaut of the industrial revolution would not be denied the fertile hills and valleys of the American Frontier.<sup>56</sup> Remini, however, skirts this possibility, asserting that the policy of Removal was never just a land grab, but an affirmative effort on the part of Jackson to save the Five Civilized Nations by relocating them in the West.<sup>57</sup>

Undoubtedly, in the early years of the Nineteenth century, the Indians posed a significant threat to national security. However, wars, treaties, and

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<sup>49</sup> REMINI at 237. Treaties executed pursuant to this act are codified at 7 Stat. 138, *et seq.*

<sup>50</sup> REMINI at 238.

<sup>51</sup> *Id.*

<sup>52</sup> REMINI at 280.

<sup>53</sup> *Id.* at 237.

<sup>54</sup> *Id.* at 279.

<sup>55</sup> ANTHONY F. C. WALLACE, *THE LONG AND BITTER TRAIL: ANDREW JACKSON AND THE INDIANS* 48 (1993).

<sup>56</sup> *Id.* at 6 (citing voracious worldwide demand for American cotton); *see also* REMINI at 237.

<sup>57</sup> REMINI at 280 (referring to the Creek, Cherokee, Choctaw, Chickasaw and Seminole tribes).

demographics wholly eliminated that threat by 1830. Remini suggests that Jackson recognized this fact, yet remained resolute in his belief that Removal was the only course of action capable of preserving the Indians' culture and preventing their extinction. The plausibility of this explanation must be questioned in light of Jackson's steadfast utilitarian approach to the Indian problem, so aptly portrayed earlier in the book. Indeed, Remini offers no authority to directly support his theory of Jackson's motive, and the reader is merely left with the desire to believe that a laudable end resulted from contemptible means.

Despite Remini's strained attempt to end on a moral high note, he remains true to his opening promise. He expertly analyzes a complicated policy driven by a complex man without making excuses to appease current sensibilities. *Andrew Jackson and His Indian Wars* is a frank, entertaining and thought provoking commentary on the extent to which fear and mistrust may drive national policy.

# BLIND EYE: HOW THE MEDICAL ESTABLISHMENT LET A DOCTOR GET AWAY WITH MURDER

BOOK REVIEW BY MAJOR MATTHEW J. RUANE\*

By dissecting dozens of failed investigations into the exploits of serial poison-killing physician Michael Swango, Pulitzer Prize-winning author James B. Stewart created a magnificent teaching tool for judge advocates and other lawyers, investigators, and health care professionals. The key lessons of *Blind Eye* are derived from Stewart's meticulous analyses of flawed investigations conducted by medical school faculty,<sup>1</sup> senior administrators,<sup>2</sup> experienced police,<sup>3</sup> seasoned district attorneys,<sup>4</sup> and even a law school dean,<sup>5</sup> throughout Swango's seventeen-year poisoning spree. Stewart exposes embarrassing and simple blunders in evidence gathering<sup>6</sup> and other investigative missteps that allowed Swango to kill approximately sixty patients while practicing medicine in four states and three African countries over almost two decades. Incredibly, despite repeated exposure of the facts by the national media,<sup>7</sup> it was only after publication of this book that a prosecutor finally managed to convict Swango of murder.<sup>8</sup>

Despite the valuable lessons *Blind Eye* offers, Stewart unfortunately overreaches in concluding that Swango owed his successful avoidance of the law for such a long period to the greed of the medical establishment. Indeed, in his effort to indict the medical community, Stewart often glosses over the key reason Swango eluded the law for so long: Swango was an extremely intelligent psychopath who took advantage of inefficient bureaucracies. Nevertheless, thanks to Stewart's exhaustive research and superb attention to

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<sup>1</sup> STEWART, JAMES B., *BLIND EYE: HOW THE MEDICAL ESTABLISHMENT LET A DOCTOR GET AWAY WITH MURDER* 51 (1999), [hereinafter: *BLIND EYE*]. In 2000, a paperback version was published under a slightly different title: *BLIND EYE: THE TERRIFYING STORY OF A DOCTOR WHO GOT AWAY WITH MURDER*.

<sup>2</sup> *Id.* at 81.

<sup>3</sup> *Id.* at 106, 109.

<sup>4</sup> *Id.* at 124, 151-2.

<sup>5</sup> *Id.* at 122, 129.

<sup>6</sup> *Id.* at 51, 72.

<sup>7</sup> *Id.* at 153, 161, 305.

<sup>8</sup> David Woods, *US Doctor May Have Killed 60*, 321 *BRITISH MED. J.* 657 (2000).

detail in evaluating the investigations, *Blind Eye* presents a gold mine of lessons for professionals.

This review provides an overview of the blunders that enabled Swango to practice deadly medicine, as well as an analysis of two of the basic lessons presented: the importance of early legal involvement in adverse personnel actions and the danger of giving legal opinions without carefully examining all of the relevant evidence. This review suggests that *Blind Eye* would have been a better book had the author focused more intellectual energy on the lessons learned in pursuing Swango and less on his own elusive case against the medical establishment.

## I. OVERVIEW

In his childhood, Swango was above average socially and academically, despite a home life strained by his alcoholic father's frequent deployments to Vietnam and his mother's emotional distance.<sup>9</sup> In college, however, classmates noticed Swango's gradual social withdrawal, starting in his sophomore year. As Swango withdrew, he began exploring what was to become a lifelong past-time: avidly reading about cases involving violent and gruesome death. He also began talking about going to medical school.<sup>10</sup>

At the end of his sophomore year, Swango withdrew from college and began a short and unremarkable two-year stint in the Marine Corps. Following discharge, he returned to college and pursued premedical courses exclusively. He wrote his senior chemistry thesis on the subject of ricin, a poison that kills without leaving any identifiable trace.<sup>11</sup>

After obtaining his undergraduate degree in chemistry in 1979 from Quincy College in Quincy, Illinois, Swango began his murderous odyssey as a medical student at Southern Illinois University (SIU). From the beginning, his classmates found it odd that Swango never expressed any interest in patient well-being nor offered any particular reason why he wanted to become a doctor. In fact, the only element of the curriculum for which he showed any enthusiasm was toxicology, the study of poisons.<sup>12</sup> Additionally, many students noticed that an unusually large number of patients unexpectedly died in whatever ward Swango was assigned. This phenomenon was obvious enough to earn him the nickname "Double O Swango," meant to imply that, like the famed fictional James Bond, British Agent 007, Swango had a license to kill.<sup>13</sup>

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<sup>9</sup> BLIND EYE at 25.

<sup>10</sup> *Id.* at 26.

<sup>11</sup> *Id.* at 27.

<sup>12</sup> *Id.* at 29.

<sup>13</sup> *Id.* at 34.

With his medical degree from SIU in hand, Swango pursued several short-lived internships at various hospitals throughout the country. Carelessness allowed the school that accepted him as an intern, Ohio State University, to overlook a warning letter from Swango's medical school cautioning the university's faculty that there had been concern about his professional behavior.<sup>14</sup> If only the letter in Swango's application file had been read, Swango would have likely been either denied employment in Ohio's internship program or watched closely enough to prevent the five poisoning deaths that occurred during his internship.

Here, Stewart overreaches and attempts to construe this tragic but simple carelessness as evidence of some greedy conspiracy by the medical establishment. He weakly supports this thesis by discussing the American Medical Association's (AMA) political opposition to physician misconduct reporting laws.<sup>15</sup> However, this support is misplaced because there is no nexus between the AMA's political agenda and Ohio State's carelessness in overlooking the written warnings on Swango. Stewart's view on this point should not distract the reader from the real lesson, which is the critical importance of attention to detail in administrative matters.

Despite a 1986 conviction and two-year prison term for nonfatal poisoning of coworkers' soft drinks and donuts, Swango continued to gain employment and access to patients in a succession of hospitals after his release in 1988 through 1997. Blundering administrators at South Dakota and New York hospitals accepted Swango's explanation that the 1986 poisoning conviction was actually a miscarriage of justice. As the limited information that they received from the AMA and state licensing authorities did not contradict Swango's excuses, he was accepted into the South Dakota and later, New York residency programs. Had administrators simply contacted the appropriate courthouse, they would have learned that there was ample proof at trial that Swango had repeatedly poisoned his ambulance service coworkers

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<sup>14</sup> *Id.* at 56, 60.

<sup>15</sup> *Id.* at 168. Here, the author presents useful background information on the system used to facilitate a comprehensive review of health care practitioners' professional credentials, the National Practitioner Data Bank (NPDB). Authorized by the Health Care Quality Improvement Act of 1986, 42 U.S.C. § 11101 *et seq.*, it was not inaugurated until 1990 and was not retroactive to the period involving the Swango's early identified medical school deficiencies, suspicious patient deaths, and the resulting investigations. Therefore, it had no direct bearing on the Swango case. Nevertheless, BLIND EYE's discussion is instructive for anyone with an interest in medical provider credentialing and privileging. In the Department of Defense (DoD) health care system, NPDB reporting is governed by DoD Instruction 6025.15, *Implementation of Department of Defense Participation in the National Practitioner Data Bank*, Oct. 12, 2000. In the Air Force, the following regulations are relevant to NPDB reporting and medical provider competence determinations: Air Force Policy Directive 44-1, *MEDICAL OPERATIONS*, Sept. 1, 1999; Air Force Instruction (AFI) 44-119, *Medical, CLINICAL PERFORMANCE IMPROVEMENT*, Aug. 1, 2000; and AFI 51-302, *Law, MEDICAL LAW*, Dec. 1, 1995. See also *National Practitioner Data Bank* at <http://www.npdb-hipdb.com/npdb.html> (last visited Feb. 27, 2002).

with arsenic-laced soft drinks and donuts. Given the lack of courthouse contact, it was not until network producers of the television show, “The Justice Files,” aired an episode on Swango’s past that South Dakota administrators learned of Swango’s misdeeds and ended his residency.

Despite the widespread publicity, at least some did not know about his notoriety: Swango gained admittance to a New York residency without the hospital administrators’ knowledge of his story. To gain admittance, he again lied about the poisoning conviction on his application, which worked because the administrators failed to check with prosecutors or the court for details of the case. The full truth of the Swango story reached New York administrators only after their South Dakota counterparts learned through informal contacts that Swango had obtained new employment in New York. Upon learning of his new position, South Dakota administrators phoned the New York hospital, effectively ending Swango’s residency there. If the administrators had taken the time to call the district attorney who had prosecuted Swango, these hospitals would have learned about Swango’s gruesome past. Almost certainly, several subsequent New York murders would have been prevented.<sup>16</sup>

Following Swango’s aborted South Dakota and New York medical residencies, New York hospital officials contacted Federal Bureau of Investigation (FBI) officials who opened an investigation. However, Swango quietly left the United States for medical employment in Africa before the FBI found sufficient evidence of murder to arrest him. The tragedy is that while the FBI struggled to develop probable cause to arrest Swango for murder, it overlooked the strong case it had against him for submitting false statements to gain the position in the New York hospital.<sup>17</sup> Distracted by his premise that the medical establishment’s greed was to blame for Swango’s gruesome crimes, Stewart misses yet another opportunity to emphasize the importance of careful and comprehensive legal analysis.

Initially, African hospitals fared much better in investigating Swango. Immediately after suspicious deaths occurred in the rural Zimbabwe hospital where Swango worked, the hospital staff suspended his practice and contacted the police. The resulting search of Swango’s quarters yielded a large supply of poisons, including potassium chloride, a deadly chemical compound that is undetectable in human bodies after death. Although the Zimbabwean authorities reacted quickly, notifying police who were able to preserve key evidence, authorities failed to arrest him before he took his medical practice to

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<sup>16</sup> BLIND EYE at 172, 206.

<sup>17</sup> *Id.* at 217. Swango lied to New York administrators, telling them that the circumstances surrounding his 1986 “assault” conviction involved a “bar fight” when, in fact, the truth was that he had poisoned coworkers’ snacks and drinks with insect poison. Since the hospital was a Veterans Affairs facility, Swango violated 18 U.S.C. § 1001, generally prohibiting false representations to the federal government. *United States v. Swango*, 172 F.3d 39 (2nd Cir. 1999).



another town. Unfortunately, Swango was able to claim victims in another African hospital before authorities closed in on him again. After the African bureaucracy spread word of Swango's murderous medical practice and closed other potential avenues for his employment in Africa, he began to look elsewhere.<sup>18</sup>

During Swango's sojourn in Africa, U.S. authorities finally devised a strategy to prosecute him. The Justice Department issued a warrant for his arrest for the false statements he had made to the New York hospital, and he was finally arrested on June 27, 1997, while traveling through the United States, on his way from Johannesburg, South Africa, to accept a medical position in Saudi Arabia.<sup>19</sup> Thereafter, Swango was convicted and sentenced to jail for forty-two months, during which time the Justice Department conducted an exhaustive search for evidence of murder in the dozens of suspicious patient deaths that occurred under his care.<sup>20</sup>

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<sup>18</sup> BLIND EYE at 280. When Air Force medical facilities are asked to provide "references" for staff or former staff with practice privileges and the subject of the records does not give permission for access to records, the medical facility staff may refer to the "routine uses" provision of rules governing the releasability of Air Force medical provider records to third parties. These rules are contained at 62 Fed. Reg. at 61495 (Nov. 18, 1997), and provide, in pertinent part, as follows:

[Medical provider] credential review files...including curriculum vitae, list of approved privileges, copies of diplomas and certificates, records of continuing health education training, letters of evaluation, summaries of special activities or other information, including malpractice claims reports, furnished or solicited in order to fully evaluate the professional qualifications of individuals, and the records of any actions taken on the individual's credentials...and...health education records...including applications for training, training reports, Faculty Board reports, photograph or negative, and personnel documents related to training may be disclosed outside the Department of Defense as a routine use pursuant to 5 U.S.C. § 552a(b)(3)...to a governmental board or agency or health care professional society or organization if such record or document is needed to perform licensing or professional standards monitoring related to health care practitioners who are or were formerly members or employees of the Armed Forces, and to medical institutions or organizations wherein such member or employee has applied for or been granted authority or employment to provide health care services if such record or document is needed to assess the professional qualifications of such member or employee. Additionally, records concerning civilian consultants or contractors who engage in direct patient care may be released to civilian organizations employing said civilian consultants or contractors providing direct patient care to eligible beneficiaries if such records are necessary to evaluate the civilian consultant or contractor in accordance with 10 U.S.C. § 1102(c)(E).

<sup>19</sup> BLIND EYE at 285.

<sup>20</sup> *Id.* at 303.

*Blind Eye* offers many lessons relevant to legal and health care professionals and to laypersons involved in employment-related adverse actions. Two such lessons, particularly instructive to judge advocates,<sup>21</sup> are the importance of early legal involvement in adverse personnel actions and the danger of providing legal opinions without carefully reviewing all of the relevant evidence.

## II. EXAMPLE CASE STUDIES

### A. Early Legal Involvement in Adverse Actions

In 1982, Swango's senior year at SIU, the medical staff attempted unsuccessfully to expel him for cheating and endangering patients. The school's administrative proceeding arose after Swango's obstetrics and gynecology (OB/GYN) professor determined that Swango had submitted fabricated reports on patients' progress.<sup>22</sup> The OB/GYN professor swiftly referred the matter to the OB/GYN faculty, and they agreed with the professor's allegation.

The faculty was "appalled and angry at Swango's brazen misconduct and dishonesty which very well may have posed a threat to patient health."<sup>23</sup> In particular, the faculty's departmental chairman concluded that Swango was a "bald faced liar" and said that such misconduct alone was sufficient grounds to expel him.<sup>24</sup> If the school expulsion committee had agreed with this assessment, Swango's path to becoming a serial killing-doctor would have ended right there.

Unfortunately, the expulsion committee did not review the same evidence because the OB/GYN faculty failed to preserve copies of the incriminating reports. Incredibly, the faculty left the original and all copies of the reports in the patient medical records, which Swango could still access. Later, when the faculty sought to show them to the expulsion committee, they were missing. Owing to the lack of evidence, the expulsion committee did not unanimously agree that Swango had cheated and thus, according to its own

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<sup>21</sup> Air Force Judge Advocate practice is very broad, with a typical military attorney's assignment including responsibilities in both criminal prosecutions and administrative employment actions. Department of the Air Force, *Air Force Online Recruiting Brochure*, at <http://www.jagusaf.hq.af.mil/FAQs/lawtypes.htm> (last visited Oct. 18, 2001) (FAQ: What Types Of Law Do Air Force Judge Advocates Practice?).

<sup>22</sup> These patient reports are the staple of medical student learning and a record of hospital inpatient progress. While other students devoted a great deal of effort to patient interviews and physical exams that served as the basis for their patient reports, Swango never performed such exams; rather, he simply fabricated them in his reports.

<sup>23</sup> *Id.* at 49.

<sup>24</sup> *Id.* at 52.

rules, Swango could not be expelled.<sup>25</sup> Sadly, some basic, early legal guidance on safeguarding evidence in the faculty's proceeding might have stopped Swango's murderous medical career before it got started.

In discussing this episode, Stewart unconvincingly implies that SIU did not expel Swango out of a fear of litigation. A careful reading reveals that, to the contrary, SIU took the allegations of cheating very seriously and took immediate steps to investigate. Once convinced that the charges were valid, the staff proceeded deliberately, though unsuccessfully, against Swango through its established hearing process. Although Stewart attempts to make much of the fact that Swango hired an attorney, he fails to acknowledge that the attorney did not stop SIU from seeking the maximum punishment, expulsion. Upon having failed in its expulsion attempt, the school devoted significant resources to keep Swango under close scrutiny for the remainder of school term and gave him extra assignments with the faculty's strictest professors.<sup>26</sup> The school's response was not that of a lazy or litigation-fearing medical system as Stewart argues; rather, the institution simply lacked legal acumen on the matter.

### **B. The Danger of Giving Legal Opinions without Carefully Reviewing All of the Facts**

In 1984, another opportunity to stop Swango was lost when attorneys reviewing accusations of poisoning failed to aggressively seek out and review all of the relevant evidence. At this time, Swango was a general surgery intern at Ohio State University Hospital. A nurse and two patients saw Swango administer an unscheduled injection to one of the patients, Mrs. Cooper. Within minutes, Mrs. Cooper suffered a respiratory arrest and might not have survived the episode without the quick actions of the nurse. The nurse immediately informed the staff of what she had seen, and Mrs. Cooper accused Swango of poisoning her. For his part, Swango gave conflicting stories to the staff, first denying being in the room, and later stating that Mrs. Cooper had complained that her feet were cold and that he was putting her slippers on them.

Another disturbing fact is that a second nurse saw Swango discard a used syringe in a vacant room a few minutes after the episode. She wrapped it in paper and gave it to the hospital's chief nurse who put it in a desk drawer.

The medical staff convened an emergency meeting to consider the accusations and requested an attorney attend as well. Despite strenuous objections by the nurses, the attorney disregarded the eyewitness accounts and the potential evidentiary value of the syringe. He incorrectly reasoned that

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<sup>25</sup> *Id.* at 52.

<sup>26</sup> *Id.* at 53.

because hospitals routinely use syringes for many types of legitimate medical purposes, the syringe that had been kept by the chief nurse had no particular significance; thus, he overlooked the fact that testing of this particular syringe may have produced useful evidence of the crime and that the syringe may have been used to corroborate eyewitness testimony. Rather, the attorney simply concluded that there “wasn’t any credible evidence of a crime” and did not recommend contacting the police.<sup>27</sup> With this hasty opinion and recommendation, the attorney lost the opportunity to collect and analyze potentially critical evidence when the trail was fresh.<sup>28</sup>

Unfortunately, the attorney’s advice did not get any better when the staff meeting reconvened a few weeks later. The staff reviewed the evidence collected in a cursory in-house investigation conducted by one of the physicians. This time, scant attention was paid to three eyewitnesses. The investigator inexplicably disregarded one of the eyewitnesses, a patient who witnessed Swango injecting Mrs. Cooper. He described the two remaining witnesses as “a crazy patient who had an unusual episode and a nurse who saw something.” He asked, “Is that enough to prove anything?”<sup>29</sup> Maddeningly, with only this information, the lawyer then opined that there was “no legal basis for accusing Swango of a criminal act or, for that matter, even removing him from the intern program.”<sup>30</sup>

This legal opinion was harshly criticized by the Dean of the Ohio State University Law School who reviewed the case after Swango was implicated in other poisonings. The Dean concluded that based on the testimony of the witnesses alone, the situation should have been investigated further. Additionally, he said “assuming hypothetically that all three witnesses to an event are psychotic, the fact that they report the same basic fact would preclude rejection of all three versions due to the psychosis of each individual witness.”<sup>31</sup> This incident provides a superb lesson for attorneys to vigorously investigate and rigorously evaluate available evidence before rendering a legal opinion.

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<sup>27</sup> *Id.* at 76.

<sup>28</sup> *Id.* at 72. Apparently, the doctor who conducted the investigation did not focus on the syringe because he believed the nurse had found it in the hospital the morning after Cooper’s death, believing it used in routine hospital care, with no nexus to the crime. This makes no sense, given the then existing allegation that in the same hospital location, an unscheduled injection administered by a person not ordinarily in the patient’s room had almost killed the patient, and given that a syringe used in the crime might have distinguishing characteristics that could link it, from an evidentiary standpoint, to the crime, or, alternatively, might somehow be tied to the crime by the testimony of the nursing staff who indeed had already discussed with the hospital’s attorney events surrounding a discarded syringe.

<sup>29</sup> *Id.* at 83.

<sup>30</sup> *Id.* at 80.

<sup>31</sup> *Id.* at 127-8.

Stewart analyzes this episode quite deftly. He notes that the fact that the investigator was a staff member probably colored the investigator's conclusions, which, in turn, handicapped the lawyer. Additionally, he concedes that the first lawyer who evaluated the case on short notice was out of his element because he was a probate law specialist. Finally, Stewart questions the objectivity of the hospital's primary legal advisor (from the office of the state attorney general) because the state funded the hospital's self-insurance program. In sum, Stewart makes a convincing case that the university's obsession with its image and concern for its self-insurance coffers inhibited the kind of critical, objective analysis that was necessary in building a case against Swango.

### III. CONCLUSION

*Blind Eye* contains a treasure trove of important lessons for medical professionals, investigators, and attorneys. Unfortunately, Stewart's attempt to assign blame on the medical establishment somewhat obscures several of these important points. Nevertheless, *Blind Eye* is an excellent review of seventeen years of investigative work so inadequate that it allowed one of the world's worst serial killers to use his status as a doctor to readily take many lives in medical institutions on two continents over the course of almost two decades.<sup>32</sup>

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<sup>32</sup> *Id.* at 306.