The last figure—$91,100—is the amount of distributable net income. *See* Treas. Reg. § 1.652(c)-4(f).

In this example, the rental expenses are directly attributable to the rental income and are allocated thereto. The trustee's commissions, which are not directly attributable to any particular item of income, are allocated to tax-exempt interest on a pro rata basis. The trustee's commissions not allocated to tax-exempt income, being indirect expenses, are allocated by the trustee to rental income; thus the trustee has allocated the remaining indirect expenses to rental income, rather than dividend income, so as to preserve the tax benefits attaching to dividends.

Character of Distributions

As mentioned before, the amounts that are included in the gross income of the beneficiary retain the same character in his hands as they had in the hands of the trust. Each beneficiary will be treated as receiving his proportionate share of the total distributable net income of the trust, with each share consisting of proportionate shares of each item of income—less deductions allocable thereto—that went into the total of the distributable net income. This conduit principle is utilized to the advantage of the beneficiary in the following situations:

- If the beneficiary's proportionate share of distributable net income includes items of tax-exempt interest, then he will exclude from gross income his proportionate share of the tax-exempt interest.
- If the beneficiary's proportionate share of distributable net income includes items of foreign income from a foreign trust, those items will retain their character and will or will not be taxable to the beneficiary depending upon his taxable status with respect to them.
- If dividends received by the trust are part of the beneficiary's proportionate share of distributable net income, then the beneficiary is entitled to the dividends received credit under section 116—the $100 exclusion.
- To the extent that the beneficiary's proportionate share of distributable net income is composed of capital gains, it will be taxed to the beneficiary at the capital gains rate rather than the ordinary income rate.
- If trust distributions include partially tax-exempt income, the recipient beneficiaries are entitled to the tax benefit instead of the trust.

The point to remember is that what the government gives it must first take away.

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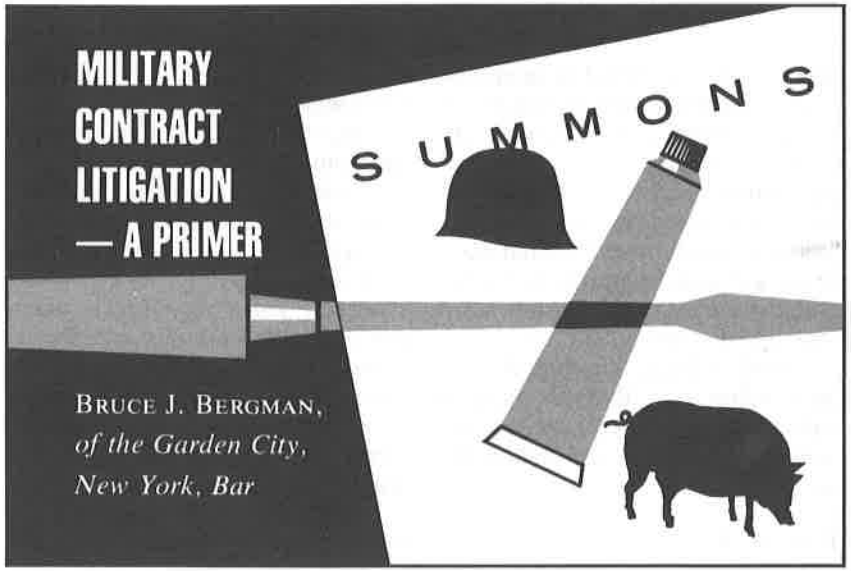

According to a report issued in September 1973 by the Senate Select Committee on Small Business, nearly all of the departments and agencies of the federal government are involved in procurement in some way. Indeed, nearly 80,000 federal employees are engaged in spending approximately one-fourth of the total federal budget through more than 20,000 firms with government contracts.

Not surprisingly, a significant percentage of government procurement is in behalf of the military—the Army, Navy, Air Force, and Defense Services Administration. When a prime contractor or a subcontractor has a problem with one of these entities, he does not sue when aggrieved. Instead, he is bound by the specific requirements of the Armed Services Procurement Regulations, commonly referred to as ASPRs, and their interpretation in case law. The ASPRs are issued by the Secretary of Defense, and they are appended to each contract in relevant part and are available upon request from the Government Printing Office.

How a dispute begins • The breadth of government procurement generally, and military procurement specifically, is staggering. The military services commission the production of everything from toilet tissue to missiles.

By way of example, suppose the

army desires to build a moderate sized recruiting center in a midwestern metropolitan area. Army technical personnel, or even outside experts hired by contract, prepare the plans and specifications for the building. The project is let pursuant to competitive bidding, resulting in a contract award to the Careful Construction Company, the lowest responsible bidder. Ignoring, for the sake of simplicity, that subcontracts would probably be involved, assume that Careful is undertaking the entire project.

DISPUTE 1

The plans and specifications provide that the footings for the building must support two tons per square foot. In addition, there is a representation in the contract that the soil will support that load.

Careful digs down to 4 feet, which its expertise in the business dictates should be sufficient. As it turns out, the soil at that depth will not support the required load. The Army's representatives for the project, the number of whom will vary with the magnitude of the job, advise Careful that it must excavate to a depth of 8 feet to comply with load factor requirements of the contract. Careful replies that the additional work is expensive and was not contemplated when it bid on the contract. It does not intend to absorb what it calculates will be an additional $25,000 in costs.

Conferences with the Army's representatives are unavailing, and Careful requests a conference with the Contracting Officer, or "C.O.," the man with the final authority for that contract. Careful requests a change order that would make the additional work officially part of the contract. The C.O., too, is unimpressed with Careful's arguments, asserting that the additional excavation is mere field work. He refuses to issue a change order, instead directing the contractor to proceed with the excavation forthwith.

Careful does not take the Army to court. Instead, it obtains from the C.O. a written version of his decision rejecting the contractor's position. This could issue as a direct result of the meeting, although it would be advisable for the contractor to write to the C.O. first, explaining its position and asking for a written decision. The C.O.'s opinion in writing is the document that enables the contractor to file an appeal with the Armed Services Board of Contract Appeals (hereafter "ASBCA").

DISPUTE 2

Notwithstanding the problem with footings, Careful must continue with the contract, hoping that its position will eventually be vindicated. For that specific issue, the C.O. no longer is involved, as it is now within the jurisdiction of the ASBCA. In the meantime, the job

goes on, and Careful is now erecting the recruiting building, which is to have concrete walls with a steel truss roof.

According to the plans, the trusses need only shop coat paint, which is how Careful orders them from a supplier. For some reason, after the trusses are erected, the Army's representatives decide that blue paint is the requirement. Careful vigorously objects and asserts that if it is compelled to repaint the trusses in place, the job will be extremely costly.

This time, the C.O. agrees that Careful is right. He, therefore, prepares a document called a change order, which officially incorporates in the work, and as part of the contract, the directive to paint the trusses blue. However, his view of the cost varies from that of Careful. This time, Careful must obtain from the C.O. a written denial on the sum that it claims and appeal that to the ASBCA.

THE DISPUTES CLAUSE • In order to establish a procedure to preclude disputes from disrupting the performance of a contract prior to its conclusion and to implement a method to settle disputes in a relatively short time, ASPR § 7-103.12, the Disputes Clause, was devised. Essentially, it provides that disputes regarding certain types of factual matters arising under a contract shall be referred to the C.O. for resolution. The relevant portion of this clause declares:

> (a) Except as otherwise provided in this contract, any dispute concerning a question of fact arising under this contract which is not disposed of by agreement shall be decided by the Contracting Officer, who shall reduce his decision to writing and mail or otherwise furnish a copy thereof to the Contractor. The decision of the Contracting Officer shall be final and conclusive unless, within 30 days from the date of receipt of such copy, the Contractor mails or otherwise furnishes to the Contracting Officer a written appeal addressed to the Secretary. The decision of the Secretary or his duly authorized representative for the determination of such appeals shall be final and conclusive unless determined by a court of competent jurisdiction to have been fraudulent, or capricious, or arbitrary, or so grossly erroneous as necessarily to imply bad faith, or not supported by substantial evidence. In connection with any appeal proceeding under this clause, the Contractor shall be afforded an opportunity to be heard and to offer evidence in support of his appeal. Pending final decision of a dispute hereunder, the Contractor shall proceed diligently with the performance of the contract and in accordance with the Contracting Officer's decision.

The Role of the C.O.

According to the Disputes Clause, the determination of the C.O. is the pivotal first step in attempting to resolve a factual dispute arising out of a military contract. The C.O. can be considered as akin to the owner's representative in the private sector. He is the man on the job who handles the questions and makes the final decisions before any legal remedies are available. Thus, it is the C.O. who decides whether Dispute 1 calls for the issuance of a change order. If he rules that it does not, that conclusion can be appealed to the ASBCA. Similarly, with regard to Dispute 2, his refusal to award Careful the amount of money it asked for complying with the change order is a final decision appealable to the ASBCA.

Ideally, the C.O. and the contractor will communicate well on an informal basis and the resulting decision will be based upon a fair exchange of documentation. If the contractor avoids the common pitfall of failing to present a coherent and documented position to the C.O. and is still aggrieved by an adverse response, he then must submit his claim in writing to the C.O. with the appropriate backup material.

The presentation of the written claim is the action that triggers the process contemplated by the disputes clause. The C.O. is then required to render his decision in writing, although there is no time limit stated during which he must act.

When an unfavorable written decision issues, or if, after a reasonable time, no decision has been rendered, the only course of action open to the contractor is to appeal to the "Secretary."

The Appeal to the ASBCA • Since the Secretaries of the various branches of the military have delegated their authority to settle disputes to the ASBCA, the appeal to the "Secretary" is in reality an appeal to the ASBCA. The notice of appeal is an informal document which requires only the following information:

- That an appeal is intended;
- Identification of the contract by number; and
- The department, agency, or bureau involved in the dispute.

Other prerequisites call for:

- The appeal to be signed personally by the appellant, by an officer, if appellant is a corporation, or by a duly authorized representative or attorney;
- An original and two copies to be submitted to the C.O.; and
- The transmittal to be within the time specified in the contract or allowed by the applicable provision

of a directive or the law—almost invariably, 30 days.

It is usual for the contractor to include a brief factual statement of his position. In the case, for example, of Dispute 2, Careful might note that it has fully complied with the contract in erecting shop coated trusses, as recognized by the change order. It might further mention that painters obviously must work more slowly in painting trusses already in place, resulting in a cost clearly in excess of what was allowed by the C.O.

While the ASBCA is not actually a court, its function is essentially the same. Moreover, although the rules of evidence are not strictly adhered to, the proceedings are generally viewed as somewhat more stringent than arbitration. The role of the ASBCA is analogous to that of a United States district court trying a case without a jury. The ASBCA decides issues of both fact and law, which are absolutely binding upon the Government, unless fraud or bad faith on the part of ASBCA was involved or there was a dearth of substantial supporting evidence.

The Rules of the ASBCA

The Rules of the ASBCA, as revised through September 1973, must be furnished in full with each C.O.'s decision, so that failure by a contractor to comply with them due to a lack of knowledge should never be a problem. Of course, if the C.O. has failed to render a decision within a reasonable time and the contractor appeals, the ASBCA Rules which would normally accompany that decision would obviously not be received. While any C.O. would probably make a copy of the Rules available upon request, they may also be obtained from the Armed Services Board of Contract Appeals, 200 Stovall Street, Alexandria, VA 22332; (703) 325-8000.

Preliminary Procedures

Rule 4 requires that within 30 days of the receipt of an appeal, the C.O. must prepare and transmit to the ASBCA an appeal file, consisting of all pertinent documents. It should include the decision appealed from, the entire contract, and the relevant correspondence between the parties. With the exception of the contract itself, for which a list of the documents is deemed sufficient, a copy of the appeal file must be furnished to the contractor within the 30-day period.

Within 30 days after the contractor receives the appeal file, he may supplement it by submitting whatever materials he feels are pertinent. If he had been writing letters to the C.O. during the course of the dispute, they are includable, even if they are purely argumentative and self-serving declarations. All the documents in the complete appeal file are considered part of the record upon which the Board renders its

decision. However, a party may object to the consideration of a document in the appeal file, and the ASBCA must then rule upon its admissibility and weight. Objections of this type are much more the exception than the rule.

Pleadings

Prolix and extensive pleadings are not contemplated by the ASBCA rules. Rule 6 (a) provides that an original and two copies of a complaint must be submitted within 30 days after the receipt of a notice of the docketing of the appeal. The complaint should set forth "simple, concise and direct statements of each (claim) . . . and the dollar amounts claimed."

As a result of this lack of formality, the complaint can be served together with the notice of appeal. Rule 2. In fact, the notice of appeal may be designated as the complaint if it meets the requirements of a complaint.

While Rule 6 requires the Government to file a simple and concise answer within 30 days of receipt of the complaint, the allegations of the complaint are usually deemed denied. The ASBCA itself may enter a general denial on behalf of the Government if no answer issues within the 30-day period.

Pleadings may be amended, but the requirements in this regard are quite liberal and rarely present problems to the litigants. *See* Rule 7.

Discovery

Rules 14 and 15 cover depositions and interrogatories. The ASBCA encourages voluntary discovery procedures, and the parties may agree upon depositions. If the parties cannot agree, the ASBCA may, upon application, order that depositions be held. Protective orders are available to avoid "annoyance, embarrassment, oppression, or undue burden or expense."

While Rule 15 states that the Board will entertain applications for permission to serve written interrogatories, but not as a matter of course, usually the parties arrange for interrogatories voluntarily. Applications may also be submitted for the inspection of documents and for the admission of facts.

Submission without Hearing

After the government's answer is received or the time to answer has expired, the contractor must decide whether to request a hearing or whether to submit on the papers. Rule 8. As a practical matter, normally the Government will permit him to exercise this election even weeks or months after the time specified. The Government, too, may waive a hearing and submit its case upon the record, as supplemented by affidavits, briefs, and even oral argument. Rule 11. A contractor usually desires to present his case at a hearing where all the facts can be amply explored. However, if he is a small businessman and perhaps not particularly well informed in his own field, counsel may be able to submit a more coherent and logical case on paper than by placing his client on the stand.

Hearings

Hearings will usually be held in Washington, D.C. Upon a request in writing and for good cause—usually a question of cost—hearings can be had at a location more convenient for the parties. Rule 17. Recent statistics indicate that on 48 per cent of all hearing days, 64 per cent of all hearings took place outside of Washington.

When a hearing has been requested, the ASBCA may require the submission of prehearing briefs. Rule 9. Even if not requested, either party may, on proper notice, submit such a brief, and it is generally considered to be good practice to do so.

Rule 10 provides that a prehearing or presubmission conference to simplify, clarify, and limit the issues may be held upon the initiative of the ASBCA or application of either party. Obviously, whether such a conference is appropriate will depend upon the nature of each particular case.

The Accelerated Procedure

Where an appeal involves a sum of $25,000 or less, as defined in Rule 12, either party may elect to process the appeal under a shortened procedure. If, as usual, no objection is entertained, the parties are encouraged to waive pleadings, discovery, and briefs, though only to an extent consistent with an adequate presentation of the case.

Under this rule, the ASBCA is required to try to render its decision within 30 days after the close of the case. In fact, the 1976 annual report of the ASBCA states that for the fiscal year ending June 30, the average time for decision was 13 days, with the median—7 days. Thus, if time is a significant factor, as is likely to be the case where a contractor is in financial distress, the provisions of Rule 12 should be carefully evaluated by counsel.

Appellate Review

The decisions of the ASBCA may be appealed to the federal district court if the amount in controversy is $10,000 or less. Amount notwithstanding, the Court of Claims is always a proper forum for an appeal from the decision of the ASBCA. Further appeals go to the United States Circuit Court of Appeals and the Supreme Court.

On appeal, the decision of the ASBCA is final as to questions of fact, unless it is "fraudulent, or capricious, or arbitrary, or so grossly erroneous as necessarily to imply bad faith, or not supported by substantial evidence." On the other

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hand, the rulings on questions of law can be appealed without any limitations. *See* 41 U.S.C. § 321-322, the so-called "Wunderlich Act." If the court concludes that further facts are needed to reach conclusions of law, the case can be remanded to the ASBCA for additional findings of fact.

WHEN COURTS HAVE ORIGINAL JURISDICTION • The Disputes Clause virtually assures that questions under government contracts will be handled initially by administrative process. Almost any disagreement can be considered to have arisen "under this contract." It is difficult indeed to conceive of a "pure breach" situation, although practitioners have, on occasion, attempted to cast their claims in these terms—most often, with little success.

In the rare case where the asserted claim is not based on a clause in the contract but the allegation is that there was a breach of the contract, there are some choices. Where the claimed amount is $10,000 or less, the contractor may sue either in the appropriate federal district court or the Court of Claims in Washington, D.C. Should the claim be in excess of $10,000, then the Court of Claims is the only proper forum. The district courts also have original jurisdiction, regardless of the amount in dispute, when injunctive relief or a declaratory judgment is sought. Such remedies, too, are rarely encountered in government contracts cases.

WHERE TO FIND THE LAW • J. McBRIDE & I. WACHTEL, GOVERNMENT CONTRACTS—LAW, ADMINISTRATION, PROCEDURE (Matthew Bender & Co., Albany, N.Y.). The definitive sourcebook of the law and principles involved in government contracts. It is a multivolume looseleaf set, with extensive explanations, copious case citations, and a helpful index.

BOARD OF CONTRACT APPEALS DECISIONS (CCH) contains all the published decisions of all the various Boards of Contract Appeals, each with an explanatory headnote. The volumes are hardbound and contain decisions by date. Other reporters are THE GOVERNMENT CONTRACTOR (Federal Publications) and FEDERAL CONTRACT REPORTS (BNA).

BRIEFING PAPERS (THE GOVERNMENT CONTRACTOR) (Federal Publications) is a bimonthly series of articles on specific issues in the field of government contracts. Each paper is very clearly presented in a logical fashion and contains case citations. There is an annual bibliography, and hardbound collections of prior articles are available.