

# The Revised and Updated DFARS Ground and Flight Risk Clause

By DONALD J. CARNEY



On June 8, 2010, the United States Department of Defense (DoD) implemented significant changes to the DoD Federal Acquisition Regulation Supplement (DFARS) provisions and clauses implementing DoD's longstanding policy of limited self-insurance for the risk of contractor military aircraft operations. The Defense Contract Management

Agency (DCMA) initiated these changes, which included merging the DFARS 252.228-7001 (Sept. 1996) Ground and Flight Risk Clause and the DFARS 252.228-7002 (Sept. 1996) Aircraft Flight Risk Clause (AFRC) into one clause applicable to all aircraft contracts "for clarity and consistency."<sup>1</sup> The result was the new DFARS 252.228-7001 (June 2010) Ground and Flight Risk Clause (GFRC).

DoD also took the opportunity to make other changes relevant to aerospace contractors. It increased contractors' deductibles under most fixed-price contracts, required prime contractors to flow down the GFRC to lower-tier contractors, and highlighted the fact that several categories of insurance costs connected with contractor operation of military aircraft under cost-reimbursable contracts are unallowable.<sup>2</sup> The new GFRC also recognized and addressed developments in the aerospace industry, such as the increased use of commercial item and service contracting in military aircraft operations and the increased use of unmanned aerial vehicles (UAVs).

This article discusses some of the key changes in the new GFRC compared to the prior contract clauses, and identifies some of the compliance and contract administration issues relevant to aerospace government contractors.

## DoD's Policy of Limited Self-Insurance

For several decades, DoD's contracting policy has been to self-insure for the risk of loss of contractor aircraft ground and flight operations, based on the premise that the self-insurance risk of loss presented is less than the costs of commercial insurance.<sup>3</sup> The comptroller general explained that this policy is based on the proposition that "the Government is financially able to absorb its maximum probable loss and the fact that its risks are spread so widely as to result in a minimal statistical probability that losses will

exceed insurance premiums over a reasonable period of time."<sup>4</sup> It therefore should be "less costly" for the government to assume the risk of loss than to purchase insurance, since purchased insurance costs would include not only policyholder losses, but selling, administrative, and other expenses as well.<sup>5</sup>

The DFARS currently implements this policy by including a prescriptive provision directing the contracting officer to use the GFRC in "all solicitations and contracts for the acquisition, development, production, modification, maintenance, repair, flight, or overhaul of aircraft," subject to certain exceptions discussed further below.<sup>6</sup> According to DoD, there is a "fairly even split" between fixed-price and "flexibly-priced" contracts involving military aircraft.<sup>7</sup> Most of the contracts for aircraft repair, overhaul, and maintenance are flexibly-priced, and those contracts are "typically where the bulk of damage arises that results in liability assessments" against contractors.<sup>8</sup>

The government assumes the risk of loss in contracts including the GFRC for aircraft "to be delivered to the Government," including aircraft in the process of being manufactured, disassembled, or reassembled, "provided that an engine, portion of a wing, or a wing is attached to a fuselage of the aircraft."<sup>9</sup> It also applies to aircraft furnished by the contractor to the government under the contract, either before or after government acceptance.<sup>10</sup> Since the GFRC results in government assumption of the risk of loss of property prior to delivery to the government under a fixed-price contract, the GFRC differs from the general Federal Acquisition Regulation (FAR) policy that the risk of loss remains with the contractor until acceptance.<sup>11</sup> Even where a progress payment is made by the government, and results in title to progress payment inventory vesting in the government, the government typically does not bear the risk of loss.<sup>12</sup> This variance from the general FAR policy of risk of loss on the contractor is traceable back to the perceived economy associated with self-insurance. As the Government Accountability Office (GAO) has explained: "We believe it is also appropriate to apply self-insurance . . . in some circumstances, to property being manufactured by contractors for the Government, where the cost of insurance would be passed to the Government through the contract price."<sup>13</sup> In other words, the government self-insures aircraft that are the property of the contractor prior to delivery so as to avoid the inclusion of potentially exorbitant insurance costs in the price paid.<sup>14</sup>

The GFRC also applies to aircraft furnished by the government to the contractor under the contract, whether in a state of disassembly or reassembly.<sup>15</sup> It includes all government property installed, in the process of installation, or

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temporarily removed, provided that the aircraft and property are not covered by a separate bailment agreement.<sup>16</sup> For example, in *Vought Aircraft Co.*, the Armed Services Board of Contract Appeals (ASBCA) held that the GFRC covered a “Low Altitude Night Attack” electronic system preliminarily installed on a government-furnished aircraft intended to be delivered with the aircraft following completion of tests.<sup>17</sup> Finally, the GFRC also applies to nonconventional “aircraft” as may be specified in the contract.<sup>18</sup>

### Contractor Obligations

By accepting the GFRC in its contract, a contractor agrees to be bound by the aircraft operating procedures contained in the combined regulation/instruction entitled *Contractor’s Flight and Ground Operations* in effect on the date of contract award.<sup>19</sup> As the ASBCA has explained, the government assumes risks “which generally entail unusually high insurance premiums if the risk were to be assumed by the contractor. In turn the Government goal was to reduce its risks by exercising certain controls,” most notably the combined regulation/instruction.<sup>20</sup>

To comply with the combined regulation/instruction, the contractor must develop procedures that are approved by the government flight representative (GFR).<sup>21</sup> The contractor’s procedures are to be “separate and distinct from industrial or quality procedures” and are to “describe aircraft

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flight and ground operations at all operating facilities.”<sup>22</sup> If the GFR discovers a noncompliance with approved procedures or discovers the use of unsafe practices, the GFR is required to notify the contractor and the administrative contracting officer.<sup>23</sup> A noncompliance may be considered grounds for withdrawal of the government’s assumption of risk for loss or damage to government aircraft.<sup>24</sup> The government reserves the right to take such other action as may be necessary to preserve the safety and security of the aircraft.<sup>25</sup> Additionally, the government does not assume any risk of loss under the GFRC for any flight that has not received prior written approval of the GFR.<sup>26</sup>

### Government’s Assumption of Risk of Loss

Subject to certain conditions, under the GFRC, the government assumes the “risk of damage to, or loss or destruction of aircraft”: (1) in the open, (2) during operation, and (3) in flight.<sup>27</sup> The GFRC defines “in the open” to mean wholly outside of the buildings on the contractor’s premises or other

places described in the schedule.<sup>28</sup> While aircraft to be delivered by the contractor are “in the open” only when outside of the contractor’s buildings, such as hangars, aircraft furnished by the government to the contractor are treated differently, and are “in the open” at all times when in the contractor’s care, custody, or control, regardless of location, whether assembled or disassembled.<sup>29</sup> “During operation” means operations and tests of the aircraft and its installed equipment, accessories, and power plants, while in the open or in motion.<sup>30</sup> “Flight” means any flight demonstration, flight test, taxi test, or other flight made in the performance of the contract, or for safeguarding the aircraft, or previously approved in writing by the contracting officer.<sup>31</sup>

The government’s assumption of the risk of loss for aircraft “in the open” continues unless the contracting officer finds that (1) the contractor has failed to comply with the combined regulation/instruction, or (2) that the aircraft is in the open under unreasonable conditions and the contractor fails to take prompt corrective action.<sup>32</sup> If the government finds a contractor noncompliant, certain notice procedures apply.<sup>33</sup> If the contracting officer finds that the contractor failed to promptly correct the cited conditions or failed to correct the conditions within a reasonable time, the government may terminate its assumption of risk.<sup>34</sup> If the government terminates its assumption of risk, the contractor assumes the risk of loss, will not be paid any insurance costs by the government, and the “liability provisions of the Government Property clause of [the] contract are not applicable to the affected aircraft.”<sup>35</sup> In other words, the FAR 52.245-1 Government Property Clause implementing the government’s policy that contractors generally, with certain exceptions, are not held liable for losses for government property under cost-reimbursement, time-and-material, labor-hour, and fixed-price contracts awarded on the basis of submission of cost or pricing data, would not apply.<sup>36</sup> Moreover, even if the government terminates its assumption of risk under the GFRC, the contractor remains obligated to comply with all GFRC provisions, including the combined regulation/instruction.<sup>37</sup>

The government’s assumption of risk is subject to the contractor’s share of loss and deductible under the current GFRC. As discussed below, the contractor assumes and is responsible for its share of the loss, which is the lesser of the first \$100,000 of loss or damage to the aircraft resulting from each separate event, except for reasonable wear and tear and to the extent damage is caused by negligence of government personnel, or 20 percent of the price or estimated cost of the contract.<sup>38</sup> The deductible applies to each “event,” which the ASBCA has interpreted to mean loss or damage resulting from “one proximate, uninterrupted and continuing cause.”<sup>39</sup>

### Exclusions from the Government’s Assumption of Risk of Loss

Several exclusions apply to the government’s self-insurance policy. Like the Government Property Clause, the GFRC clause makes the contractor liable for any damage, loss, or

destruction of aircraft resulting from willful misconduct or lack of good faith of any of the contractor's managerial personnel to maintain and administer a program for the protection and preservation of aircraft.<sup>40</sup> This standard requires more than mere negligence. For example, in *Fairchild Hiller Corp.*,<sup>41</sup> the ASBCA sustained a contractor's appeal of a contracting officer's denial of a contractor's request to be relieved of liability for damage to a USAF C-130 aircraft that burned when in the contractor's custody for inspection and repair. While the ASBCA agreed that the contractor was negligent on the day of the fire, and that its safety program was less consistent, careful, and effective than was necessary, the record did not support a finding that the contractor failed to meet sound industrial safety procedures. The government also failed to prove that contractor management subordinated responsibility for safety to other goals to an extent that one could find willful misconduct or lack of good faith in regard to safety concerns.

The government's assumption of risk also does not extend to losses sustained during flight if either the flight or flight crew members have not been approved in advance by the GFR.<sup>42</sup> Under the GFRC, the government also does not assume the risk for wear and tear, unless the wear and tear is the result of other loss, damage, or destruction covered by the clause.<sup>43</sup> The wear and tear exclusion does not apply to government-furnished property if the damage is reasonable wear and tear or "results from inherent vice, e.g., a known condition or design defect in the property."<sup>44</sup>

The GFRC excludes losses covered by insurance.<sup>45</sup> It also excludes losses sustained while the aircraft is being worked on where the damage or loss is a direct result of the work unless such damage, loss, or destruction would be covered by insurance that would have been maintained by the contractor but for the government's assumption of the risk.<sup>46</sup> Also excluded are damages during the course of transportation by rail, or via public streets, or highways, except for government-furnished property.<sup>47</sup>

### **Prior DoD Ground and Flight Risk Clauses**

From the early 1960s<sup>48</sup> until the new rule in June 2010, DoD implemented the contractor aircraft operations self-insurance policy through two separate clauses that addressed two different circumstances.<sup>49</sup> According to DCMA, the government's intention was to have one or the other clause apply to any particular contract, except in very limited circumstances, presumably when a military aircraft contract contained both fixed-price and cost-reimbursement contract line items, or "CLINs."<sup>50</sup>

The pre-2010 GFRC applied only to negotiated fixed-price contracts for aircraft production, modification, maintenance, repair, or overhaul.<sup>51</sup> A second clause, the AFRC, applied to cost-reimbursable contracts.<sup>52</sup> While the GFRC dealt with contractor property, the AFRC was primarily intended to be used in contracts involving the furnishing of aircraft to the contractor by the government, particularly cost reimbursement contracts.<sup>53</sup> The AFRC could also be used in fixed-price contracts where the GFRC was

not used and contract performance involved the flight of government-furnished aircraft.<sup>54</sup>

The two clauses had three major differences. First, while the GFRC applied to aircraft in the open, in operation, or in-flight, the AFRC applied only in-flight.<sup>55</sup> Second, the clauses contained different deductibles. Under the GFRC, with the exception of damage, loss, or destruction in flight, the contractor assumed the risk of the first \$25,000 of loss or damage to aircraft in the open or during operation.<sup>56</sup> By contrast, the AFRC included a provision that the "loss, damage, or destruction of aircraft during flight in an amount exceeding \$100,000 or 20 percent of the estimated cost of this contract, whichever is less, is subject to an equitable adjustment when the contractor is not liable" under the Government Property

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Clause and the flight crew members had been approved by the GFR.<sup>57</sup> The equitable adjustment was to be made to the estimated cost, delivery schedule, or both, and in the amount of fee to be paid to the contractor.<sup>58</sup> The AFRC was also a limited deviation from FAR policy, which as described above generally states that contractors are not held liable for loss of government-furnished property unless certain exceptions apply.<sup>59</sup> This policy is implemented contractually in the Government Furnished Property Clause.<sup>60</sup> The AFRC included a deductible to share some of the risk of contractor flight operations.

Third, the clauses differed regarding how to handle contractor insurance costs. In the GFRC, the contractor warranted that the contract price "does not and will not include, except as may be authorized in this clause, any charge or contingency reserve for insurance covering damage, loss, or destruction of aircraft."<sup>61</sup> The AFRC contained no requirement regarding the contractor insurance costs.

### **DCMA Identified Several Problems Under the 1996 GFRC and AFRC**

By 2007, DCMA perceived several material problems with DoD's implementation of the self-insurance policy through the 1996 versions of the GFRC and AFRC. DCMA is constantly involved in administering contracts for military aircraft subject to the self-insurance policy, since DCMA normally administers contracts at sites not physically located on a military base, such as contractor facilities.<sup>62</sup> DCMA concluded that the GFRC and AFRC were, among other things, not being correctly included in aircraft contracts,

contained deficient language, did not operate properly, and did not impart the obligations on military aerospace contractors as DCMA intended.<sup>63</sup> On April 5, 2007, the DCMA put before the Defense Acquisition Regulations Council a proposal to eliminate the separate AFRC and to update and combine its provisions into a single, consistent, and clear GFRC.<sup>64</sup>

DCMA indicated that DoD itself was confused as to the applicability of the GFRC and AFRC clauses. Specifically, DCMA found that the military services were “inconsistent

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in their application of the clauses to Government contracts.”<sup>65</sup> Even though DCMA believed that the government’s intention was to include one or the other clause in military aircraft contracts but not both, “both clauses have, at times, been included in the same contract,” apparently without justification.<sup>66</sup> Moreover, DCMA and the military services were repeatedly confronted with “numerous questions on clause interpretation and collateral compliance-related matters.”<sup>67</sup> One feature of the existing clauses contributing to the questions was the “different coverage and deductibles.”<sup>68</sup> DCMA therefore concluded that the GFRC and AFRC and their prescriptive regulation, DFARS 228.370, needed clarification and revision.

DCMA was particularly concerned with the possibility that contractors were actually better off if the government found contractors noncompliant with the combined regulation/instruction.<sup>69</sup> If, as a result, the government withdrew its assumption of the risk of loss, all damage to government-furnished aircraft “arguably” fell under the Government Property Clause.<sup>70</sup> The DCMA observed that the Government Property Clause treats contractor damage to government aircraft “much more favorably than either the GFRC or AFRC.”<sup>71</sup> In the revised regulatory provision, the government revised the clause to make inapplicable the liability provisions of the Government Property Clause if the government terminates its assumption of risk.<sup>72</sup>

DCMA also had three other major concerns. First, DCMA was concerned with the differing deductible amounts under the GFRC and AFRC, and the perceived

insufficiency of the \$25,000 GFRC deductible to deter unsafe contractor practices associated with aircraft manufacture, maintenance, and overhaul.<sup>73</sup> DCMA also stated that the standard might be too costly for some smaller contracts, such as contracts for paint or minor repairs, unless the rule was revised to allow the deductible to be capped at 20 percent of the contract cost.<sup>74</sup>

Second, DCMA perceived that prime contractors were not consistently requiring subcontractor compliance with the clauses or the combined regulation/instruction.<sup>75</sup> In the absence of a mandatory flowdown, DCMA concluded that government aircraft were at unnecessary risk of damage because of the absence of the requirement to comply with the combined regulation/instruction.

Third, DCMA was concerned about the potential for contractor claims for reimbursement of insurance costs under cost-type contracts where the government was already acting as the self-insurer under the contracts. This raised the possibility that the government was paying contractor costs for insurance regarding risks already covered by the government. To “reap the benefits of the self-insurance program, the costs of commercial insurance that duplicate the government’s self insurance and the contractor’s deductibles under the GFRC and AFRC” had to be borne by the contractor, according to DCMA.<sup>76</sup> Even though FAR 31.205-19 arguably already precluded contractor recovery of certain of these costs from the government, DCMA perceived the need to highlight the unallowability of these costs. Otherwise, DCMA feared, the benefits to the government of the self-insurance program would be undercut.

DCMA forwarded proposed revised DFARS language to the DAR Council that included proposed revisions to the clauses intended to address these concerns and combining the AFRC into the GFRC, revisions to the prescriptive provision, and other updates and revisions to the terms of the newly combined contract clause.<sup>77</sup> On December 7, 2007, DoD published the new GFRC clause as a proposed rule in the *Federal Register* and received comments from DCMA field offices and the Aerospace Industries Association.<sup>78</sup>

DoD implemented some of the suggestions offered by commenters and published a final rule on June 8, 2010.<sup>79</sup> The final rule adopted the single GFRC, revised the prescriptive DFARS provision, and added a new DFARS provision recognizing that the cost limitations in FAR 31.205-19, Insurance and Indemnification, on self-insurance and purchased insurance costs are subject to the requirements of the new DFARS 252.228-7001 (June 2010) GFRC.<sup>80</sup>

The final rule implementing the DFARS 252.228-7001 GFRC (June 2010) included several relatively uncontroversial, yet important, provisions limiting the applicability and scope of the clause. For example, the prescriptive DFARS provision added certain new exceptions to the clause’s applicability. The new GFRC clause does not apply to activities incidental to the normal operations of aircraft (e.g., refueling operations, minor nonstructural actions not requiring towing, such as replacing aircraft tires due to wear and tear).<sup>81</sup> It also does not apply to contracts awarded



under FAR Part 12 procedures nor to commercial derivative aircraft that are to be maintained to Federal Aviation Administration (FAA) airworthiness standards when the work will be performed at a licensed FAA repair station.<sup>82</sup> Like the prior provision, the GFRC also does not apply where a non-DoD customer (including a foreign military sale customer) has not agreed to assume the risk of loss or destruction of, or damages to, aircraft.<sup>83</sup>

The final rule also contained several new provisions reflecting DCMA's concerns with the complexity, consistency, and effect of the GFRC. These provisions are of varying degrees of significance to aerospace government contractors and are discussed in detail below.

### **Increase in Fixed-Price Contract Deductible from \$25,000 to \$100,000**

One significant change for aerospace contractors in the revised GFRC is the deductible level of \$100,000 for all DoD aircraft contracts, including fixed-price contracts that previously were subject to a \$25,000 deductible. The regulatory history of this specific provision suggests that the DoD placed simplicity over well-founded economic analysis when it adopted this provision for all aircraft contract types.

In January 2007, prior to recommending the proposed revised GFRC, DCMA looked into current industry practices regarding deductibles for aircraft liability, hangarkeeper's liability, and similar insurance coverages under the GFRC in the form of a contractor insurance/pension review by the DCMA Contractor Insurance/Pension Division (deductibles CIPR).<sup>84</sup> DCMA noted that the deductible applicable to fixed-price contracts increased from \$1,000 in the 1991 version of the GFRC to \$25,000 in 1996. DCMA's review concluded that "\$25,000 seems to be the median of deductibles for property damage under hangarkeeper's insurance policies that are very roughly comparable to the terms" of the GFRC clause, aside from certain outlier examples.<sup>85</sup> Based on this initial assessment, DCMA's insurance experts did "not see any compelling reason to change the amount at this time" of the fixed-priced deductible.<sup>86</sup> Moreover, DCMA concluded that the \$100,000 deductible under the AFRC "if anything, seems to be higher than that typically seen in our samples" of insurance policies.<sup>87</sup>

Notwithstanding the findings of the deductibles CIPR, DCMA's initially proposed rewrite of the GFRC in April 2007 included a deductible of \$50,000, or 20 percent of contract costs for all military aircraft contracts. As discussed above, DCMA justified the amount to deter unsafe contractor practices on fixed-price contracts. When DoD published the proposed rule, however, the proposed deductible increased to \$100,000 for all aircraft contracts.<sup>88</sup>

While an industry representative commended DoD's efforts to streamline the DFARS in general, it protested the increase to \$100,000 as potentially too high. It noted that while "historically most contractors engaged in the types of contracts that would utilize the Ground and Flight Risk Clause have been large business concerns," the revised GFRC could negatively impact small businesses.<sup>89</sup> Specifi-

cally, small subcontractors, which "do not have program resources to absorb an increased share of loss," could effectively be excluded from these contracts.<sup>90</sup> The result would be that only large companies willing to assume a greater share of loss would compete for these contracts, and small businesses with innovative solutions and lesser financial means would be excluded. Industry therefore recommended modifying the maximum share of loss to \$50,000, "so as not to exclude small businesses with which a prime contractor may wish to partner."<sup>91</sup>

DoD rejected the \$50,000 maximum deductible as "inequitable and counter-productive."<sup>92</sup> With only very general references to its review of military aircraft contracts, DoD disagreed that raising the liability limit would disproportionately disadvantage small businesses. In specific, DoD contended that "most of the small businesses participating in these contracts do so as [cost-type contract] repair, overhaul, and maintenance prime contractors," and therefore were already subject to the \$100,000 maximum limitation.<sup>93</sup> DoD alternatively noted that small businesses were commercial subcontractors that DoD apparently concluded would not be subject to the revised GFRC in

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the future.<sup>94</sup> During internal deliberations, DoD also noted that "DoD aircraft tend to be much more expensive than those in private industry," and that the \$100,000 deductible "adjusts the deductible to recognize the magnitude of the contract to which the deductible relates."<sup>95</sup>

DoD's application of a \$100,000 maximum deductible to fixed-price contracts under the revised GFRC does not appear sufficiently justified based on the regulatory record. First, the size of the deductible was not supported by the deductibles CIPR. The deductibles CIPR included government contractors, and no basis was given to conclude that the risks assessed for these contractors did not include more expensive military aircraft. Second, there did not appear to be a principled basis for assessing the maximum amount necessary to deter unsafe contractor practices. Industry proposed a meaningful maximum deductible of \$50,000. The government provided nothing beyond speculative assertions of necessity in support of its contention that a

\$100,000 deductible was necessary to deter unsafe practices. In increasing this threshold to \$100,000, DoD's position should have been supported by more specific evidence establishing the reasonableness of the amount. Nevertheless, contractors, particularly small contractors, must now assess whether participating in fixed-price military aircraft contracts is worth the risk of a potential unreimbursable loss of \$100,000 under the revised GFRC.

### **Mandatory Flowdown Provision**

Another material change is the new requirement that the GFRC be flowed down in all subcontracts. In specific, paragraph (m) states that the “[c]ontractor shall incorporate the requirements of [the GFRC], including this subparagraph (m), in all subcontracts.”<sup>96</sup> After DoD published the proposed rule including the flowdown requirement, an aerospace industry group objected that the mandatory flowdown requirement was overbroad, and needed to provide more flexibility in requirements imposed on subcontractors.<sup>97</sup> The commenter pointed out that there “may

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be requirements within the clause that are inappropriate for some small subcontractors under certain conditions,” and proposed that “some flexibility on imposing all of the requirements of this clause on all subcontractors be recognized” in the mandatory flowdown requirement.<sup>98</sup> The industry concern regarding the flowdown provision was perhaps not specific enough to persuade DoD.

DoD rejected this industry concern, and in so doing appeared to miss the point of the comment. DoD responded to the comment by noting that the combined regulation/instruction itself provides “adequate flexibility to address the commenter’s concern.”<sup>99</sup> Furthermore, stated DoD, “the Instruction’s standard for contractor procedures is simply that they be ‘safe and effective,’” and that any subcontractor “in possession or control of a government aircraft should have ‘safe and effective’ procedures in place.”<sup>100</sup> DoD apparently failed to realize that the commenter was addressing the entirety of the somewhat complex GFRC, not simply the combined regulation/instruction. Industry was therefore not arguing with the need for safe and effective

procedures, but rather with the inflexibility of application of a DFARS clause that, as DMCA has agreed, has both safety *and* contract components.<sup>101</sup>

The new GFRC not only compels the requirements of the clause to be flowed down to subcontractors; it also changes the liability arrangement for damages when covered aircraft are in the possession or control of a subcontractor. Under the 1996 GFRC, when an aircraft was in the possession or control of a subcontractor and the subcontract did not, with the written approval of the contracting officer, provide for relief from each liability, the subcontractor was not relieved of liability for any resulting damage, loss, or destruction.<sup>102</sup> In the absence of the contracting officer’s written approval, the subcontract was required to contain provisions requiring the return of the aircraft in as good condition as when received or for the utilization of the property in accordance with the provisions of the prime contract.<sup>103</sup> The clause required the prime contractor to enforce liability against the subcontractor pursuant to the subcontract’s terms for the benefit of the government.<sup>104</sup>

By contrast, the new GFRC does not relieve a contractor from liability for damage, loss, or destruction of aircraft while in the possession or control of a subcontractor, absent the contracting officer’s approval of such relief. New GFRC paragraph (g) entitled “Subcontractor possession or control,” states that the “Contractor shall *not* be relieved from liability for damage, loss, or destruction of aircraft while such aircraft is in the possession or control of its subcontractors, except to the extent that the subcontract, with the written approval of the Contracting Officer, provides relief from each liability.”<sup>105</sup> It states in a second sentence that, absent the contracting officer’s written approval of relief, “the subcontract shall contain provisions requiring the return of aircraft in as good condition as when received, except for reasonable wear and tear or for the utilization of the property in accordance with the provisions of this contract.”<sup>106</sup> Thus, the new GFRC makes a contractor liable to the government for damage, loss, or destruction occurring while aircraft are in the possession of a subcontractor, unless a contractor obtains advance, written approval from the contracting officer for relief of liability under the subcontract.<sup>107</sup>

The new paragraph (g) appears to create an overly narrow scope of contractor relief from liability while aircraft are in the possession or control of a subcontractor. Relief should also extend to a contractor that has flowed down the GFRC to the extent that the conditions for the government’s self-insurance identified in paragraph (d) are satisfied by a subcontractor while aircraft are in the subcontractor’s possession or control. Revision of paragraph (g) in this manner would maintain the contractor’s liability for damages to the government if a subcontractor caused damage, loss, or destruction to an aircraft, but not where a subcontractor has (1) maintained compliance with the combined regulation/instruction and (2) not held aircraft in the open under unreasonable conditions (i.e. circumstances where the government’s general policy is to agree to assume the risk as described in paragraph (d)).

Additionally, the second sentence of paragraph (g) appears to be a vestige of the 1996 GFRC that did not include the flowdown provision and therefore should be deleted. The paragraph (m) flowdown provision now necessitates the incorporation of the GFRC requirements in all subcontracts, including the requirement to be bound by the combined regulation/instruction governing flight and ground operations. Given the new GFRC's emphasis on flowing down the GFRC to subcontractors, paragraph (g) should more clearly and effectively address liability for damage occurring while aircraft are in the possession or control of subcontractors.

In summary, aerospace contractors must ensure that they flow down the GFRC in their subcontracts to both comply with paragraph (m) and to impose the contractual requirement of compliance with the combined regulation/instruction, among other terms, on subcontractors.

### **Unallowability of Insurance Costs**

The 2010 version of the GFRC includes new provisions emphasizing that certain costs relating to insurance against the contractor's share of loss under cost-reimbursement government contracts are unallowable. This provision relates directly to the DCMA's intent that duplicative contractor insurance costs be borne by the contractor, not the government, to avoid undercutting the benefits that should be accruing to the government under its self-insurance policy.<sup>108</sup> Aerospace contractors need to be aware of this restriction and to ensure that their operations and disclosure statements comply with this restriction.

The new GFRC identified five separate types of unallowable aircraft operation insurance costs. In relevant part, the clause states as follows:

The costs incurred by the contractor for its share of loss and for insuring against that loss are unallowable costs, including but not limited to –

- (i) The Contractor's share of loss under the Government's self-insurance;
- (ii) The costs of the Contractor's self-insurance;
- (iii) The deductible for any Contractor-purchased insurance;
- (iv) Insurance premiums paid for Contractor-purchased insurance; and
- (v) Costs associated with determining, litigating, and defending against the Contractor's liability.<sup>109</sup>

This provision is in stark contrast to the prior AFRC clause, which did not expressly address the allowability of these types of costs relating to cost-reimbursement contracts. As discussed above, however, FAR 31.205-19 arguably already made these costs unallowable. In any event, since these insurance costs are plainly now unallowable, they cannot be included in costs for reimbursement and are subject to disallowance by the cognizant contracting officer.<sup>110</sup> Moreover, to the extent a contractor includes these costs as an indirect cost in cost rate proposals or statements of costs, the contractor risks exposure to penalties.<sup>111</sup> Specifically, where an indirect cost is expressly unallowable under a FAR cost principle or executive agency supplement

like the DFARS, the penalty under FAR 42.709-1 is equal to the amount of the disallowed costs allocated to the cost-reimbursement contracts, plus interest.<sup>112</sup> If the indirect cost was determined to be unallowable "for that contractor" before proposal submission, the penalty is two times the amount of disallowed allocated costs plus interest.<sup>113</sup> The inclusion of unallowable costs is also potentially subject to other administrative, civil, and criminal penalties.<sup>114</sup>

It is therefore incumbent upon aerospace government contractors to ensure that the types of insurance and other costs identified as unallowable under the new GFRC do not appear either in direct cost submissions or indirect cost rate proposals or statements of costs. While the rules applicable to the reimbursement of insurance costs under cost-type contracts have received new emphasis under the new GFRC, the GFRC rule requiring contractors to promise not to include insurance charges to fixed-price contracts have remained unchanged. Under fixed-priced contracts, contractors warrant that the price of these contracts will not include any charge or contingency reserve for insurance.<sup>115</sup>

### **UAVs Included at Contracting Officer's Discretion**

One of the policy issues relating to the GFRC is the inclusion of unmanned aerial vehicles (UAVs) under the clause. Unmanned aerial systems (referring to both UAVs and their supporting systems) programs of the military services have experienced significant growth in recent years.<sup>116</sup> DCMA included UAVs in the list of aircraft with contracts that should include the GFRC and that are covered by the terms of the revised GFRC.<sup>117</sup> The revised GFRC also revised the definition of "flight crew member" to include "any pilot or operator of an unmanned aerial vehicle."<sup>118</sup>

One of the DCMA's own field representatives raised a concern regarding the inclusion of UAVs in the proposed revised GFRC. The representative suggested that the clause should not be applied to smaller UAVs, stating:

228.370 appears to require the Ground and Flight Risk Clause for all aircraft including unmanned aerial vehicles without taking into account size, cost, or ceiling which vary tremendously. The use of the GFRC appears to be a costly overkill in cases of small/micro unmanned aerial vehicles.<sup>119</sup>

This somewhat conclusory comment did not explain what it meant by "costly overkill." It is unclear whether the commenter meant that it was an error to include micro-UAVs among aircraft that would require costly insurance, or that it was overly burdensome administratively and contractually to track such aircraft pursuant to the GFRC, or that the costs of compliance were otherwise unjustified. The question of coverage of micro-UAVs under the GFRC does not appear to be inconsequential based on the numbers of these systems alone. For example, as of March 2010 the GAO reported that the military services have acquired more than 6,100 Group 1 unmanned aircraft (aircraft weighing 20 pounds or less).<sup>120</sup>


The DoD did not share the commenter's concern be-

cause of the flexibility afforded to the contracting officer under the DFARS. More specifically, in responding to the comment DoD stated that “DFARS 228.370(b)(2)(i) allows tailoring of the definition of ‘aircraft’ to appropriately cover atypical and ‘nonconventional’ aircraft” but also allowed contracting officers to omit small/micro UAVs from that definition, in coordination with the program office.<sup>121</sup> DoD acknowledged that, while the respondent’s concerns could be legitimate in some cases, these concerns should be addressed during the preaward phase on an individual contract basis. There is sufficient flexibility in the approval process for the clause to recognize unique requirements or the absence of standard ground and flight operation requirements for small/micro UAVs.<sup>122</sup>

While DoD’s response appears to recognize that the GFRC may indeed be more than is reasonably required for small/micro UAVs, it is unclear by what standard contracting officers should evaluate whether to include the GFRC in contracts for such systems.

Since it appears that the importance of UAVs will continue to grow based on recent trends, DCMA may have to revisit this issue in the future to provide more concrete guidance on the applicability of the GFRC to these systems. For the time being, aerospace contractors whose contracts cover UAVs will need to be aware of how the government is dealing with the risks of such aircraft in their contracts on a case-by-case basis.

## Conclusion

DoD’s revisions to the GFRC and its prescriptive provision have simplified how DoD implements its limited self-insurance policy for contractor operations involving military aircraft, while at the same time imposing increased obligations on contractors. DoD’s approach also increases potential contractor exposure to ground and flight risks. At the same time, DoD has highlighted the unallowability of certain risk-related costs under cost type contracts where the GFRC applies. Aerospace government contractors need to be aware of these changes and respond accordingly in their proposals and compliance plans. Moreover, aerospace contractors should be aware of these risk-shifting issues as the industry continues to evolve and increasingly uses new technologies such as UAVs. 

## Endnotes

1. 75 Fed. Reg. 32645 (June 8, 2010).
2. DFARS 252.228-7001 (June 2010). Under the current GFRC, deductibles are the lesser of \$100,000 or 20 percent of the estimated contract cost. DFARS 252.228-7001(f)(1) (June 2010). Previously, deductibles were \$25,000. See 75 Fed. Reg. 32645 (June 8, 2010).
3. DCMA, Memorandum for Director, Defense Acquisition Regulations Council (Apr. 5, 2007), “Proposed Defense Federal Acquisition Regulation Supplement (DFARS) Case—Revision of the Ground and Flight Risk, and Aircraft Flight Risk Clauses” (DCMA Memo) at 1.
4. Letter from Comptroller General of the United States to the Honorable William Proxmire, Chairman, Joint Economic Committee, Congress of the United States (June 21, 1972) (B-114811) (Comptroller General Letter) at 2.

5. *Id.*
6. DFARS 228.370(b)(1) (June 8, 2010).
7. 75 Fed. Reg. 32642, 32644 (June 8, 2010).
8. *Id.*
9. DFARS 252.228-7001(a)(1)(i) (June 2010) (defining “aircraft”) and DFARS 252.228-7001(c) (June 2010) (providing that, subject to the conditions in paragraph (d) of the clause, the Government “self-insures and assumes the risk” of damage, loss, or destruction of aircraft “in the open,” during “operation” and in “flight”). This aspect of the definition of “aircraft” was reportedly added at the suggestion of an industry group to “indicate the point at which an aircraft being manufactured becomes an aircraft, ‘otherwise even some raw materials in the open might be thought by some to be aircraft in the course of manufacture.’” Vought Aircraft Co., ASBCA No. 47357, 00-1 BCA ¶ 30,721.
10. DFARS 252.228-7001(a)(1)(iii) (June 2010).
11. See FAR 46.505(b) (2007). The risk of loss passes to the Government upon delivery of the supplies to a carrier if transportation is free-on-board (FOB) origin. See FAR 46.505(b)(2).
12. FAR 52.232-16(e) (Aug. 2010).
13. Comptroller General Letter at 2.
14. Post-delivery risk of loss is generally addressed under the FOB clauses in the FAR 52.247 grouping, and at FAR 52.246-23, Limitation of Liability (Feb. 1997) and FAR 52.246-24, Limitation of Liability—High Value Items (Feb. 1997).
15. DFARS 252.228-7001(a)(1)(ii) (June 2010).
16. *Id.*
17. Vought, *supra* note 9 (sustaining contractor appeal for system lost in crash of Government-furnished aircraft, and denying government defense that the 1975 version of the GFRC did not cover contractor-owned property).
18. DFARS 252.228-7001(a)(1)(iv) (June 2010).
19. DFARS 252.228-7001(b) (June 2010). The combined regulation/instruction is jointly issued as Air Force Instruction 10-220, Army Regulation 95-20, NAVAIR Instruction 3710.1 (Series), Coast Guard Instruction M13020.3, and Defense Contract Management Agency Instruction 8210.1, and is published by the DCMA.
20. McDonnell Aircraft Corp., 66-1 BCA ¶ 5382, 1966 WL 359 (Feb. 16, 1966) (allowing a contractor’s appeal of a contracting officer’s decision denying the contractor’s request for reimbursement under the GFRC because the radar operator, rather than the pilot, was landing the aircraft, because the radar operator was a qualified flight crew member under the GFRC in effect at the time).
21. Contractor’s Flight and Ground Operations Instruction § 3. For a discussion of the role of DCMA personnel in monitoring contractor ground and flight operations, see Statement of Lt. Col Michael J. Tremper, USAFR, GFR, DCMA, before the Committee on Science and Technology, Subcommittee on Investigations and Oversight, U.S. House of Representatives (June 12, 2007).
22. Contractor’s Flight and Ground Operations Instruction, § 3.3.
23. *Id.* § 3.1.3.
24. *Id.*
25. *Id.*
26. *Id.* § 4.1.3; DFARS 252.228-7001(e)(2) (June 2010).
27. DFARS 252.228-7001(c) (June 2010).
28. DFARS 252.228-7001(a)(6) (June 2010).
29. *Id.*; see also DFARS 252.228-7001(a)(1)(ii) (June 2010).
30. DFARS 252.228-7001(a)(7) (June 2010). See also Contractor’s Flight and Ground Operations Instruction, § 1.26—Ground Operations—Aircraft operations without the intent of flight.
31. DFARS 252.228-7001(a)(4) (June 2010).
32. DFARS 252.228-7001(d) (June 2010).
33. *Id.*
34. *Id.*
35. DFARS 252.228-7001(d)(4)(iii) (June 2010).
36. FAR 52.245-1(h) (Aug. 2010) (contractor not liable absent insurance coverage, willful misconduct or lack of good faith, or the Government’s revocation of assumption of the risk of loss).



37. DFARS 252.228-7001(d)(6) (June 2010).
38. DFARS 252.228-7001(f)(1) (June 2010).
39. The Boeing Co., ASBCA No. 18916, 74-2 BCA ¶ 10,976 (where six aircraft on a contractor's flightline were damaged by one event, a severe hailstorm, the ASBCA concluded that the deductible applied to the total damage to all aircraft, rather than to the loss or damage for each aircraft individually).
40. DFARS 252.228-7001(e)(1) (June 2010).
41. Fairchild Hiller Corp., ASBCA No. 14387, 72-1 BCA ¶ 9202.
42. DFARS 252.228-7001(e)(2) (June 2010).
43. DFARS 252.228-7001(e)(5) (June 2010).
44. *Id.*
45. DFARS 252.228-7001(e)(4) (June 2010).
46. DFARS 252.225-7001(e)(6) (June 2010).
47. DFARS 252.228-7001(e)(3) (June 2010).
48. Office of the Undersecretary of Defense, Acquisition, Technology and Logistics, DoD Contract Pricing Committee, Memorandum for Director, Defense Acquisition Regulation Council, 2007-D009, Ground and Flight Risk Clause (May 23, 2007), at 3.
49. NASA has a limited self-insurance policy for contractor operation of government aircraft similar to the DoD policy. NASA still maintains two contract clauses. First is the NASA FAR Supplement 1852.228-70, Aircraft Ground and Flight Risk (October 1996) Clause prescribed in the NASA FAR Supplement at 1828.370(a). The second is the NASA FAR Supplement 1852.228-71, Aircraft Flight Risks (December 1988) Clause prescribed in the NASA FAR Supplement at 1828.311-270.
50. DCMA Memo at 2.
51. DFARS 228.370(b)(1) (effective Dec. 15, 1998; superseded June 8, 2010).
52. DFARS 228.370(c)(1) (effective Dec. 15, 1998; superseded June 8, 2010).
53. *Id.*
54. DFARS 228.370(c)(2) (effective Dec. 15, 1998; superseded June 8, 2010).
55. Compare DFARS 252.228-7001 (Sept. 1996) and DFARS 252.228-7002 (Sept. 1996).
56. DFARS 252.228-7001(e) (Sept. 1996).
57. DFARS 252.228-7002(d)(1) (Sept. 1996).
58. DFARS 252.228-7002(d)(2) (Sept. 1996).
59. FAR 45.104. The contractor does assume the risk of loss on fixed-price contracts not requiring cost or pricing data. FAR 45.107(a)(1)(ii), (a)(2)) and FAR 52.245-1 (Alternate I) (Aug. 2010).
60. FAR 52.245-1 (Aug. 2010).
61. DFARS 252.228-7001(g) (Sept. 1996).
62. NAVAIR, Contractor Flight Operations web page, [http://www.navair.navy.mil/safety/flight\\_ops.cfm](http://www.navair.navy.mil/safety/flight_ops.cfm).
63. DCMA Memo at 1.
64. *Id.* at 3.
65. *Id.* at 1.
66. *Id.* at 2.
67. *Id.*
68. *Id.*
69. *Id.*
70. *Id.*
71. *Id.*
72. DFARS 252.228-7001(d)(4)(iii) (June 2010).
73. DCMA Memo at 2.
74. *Id.*
75. *Id.*
76. *Id.* at 1.
77. *Id.*
78. 72 Fed. Reg. 69177 (Dec. 7, 2007) (proposed rule); 75 Fed. Reg. 32642 (June 8, 2010) (final rule with descriptions of comments).
79. 75 Fed. Reg. 32642 (June 8, 2010).
80. 75 Fed. Reg. 32642, 32645 (June 8, 2010), citing new DFARS 231.205-19.
81. DFARS 228.370(b)(1)(i)(June 8, 2010).
82. DFARS 228.370(b)(1)(ii), (iv) (June 8, 2010).
83. DFARS 228.370(b)(1)(iii) (June 8, 2010).
84. DCMA, Special Consulting Contractor Insurance/Pension Review on Aircraft and Hangarkeeper's Liability, Industry Survey of Deductibles (Jan. 17, 2007).
85. *Id.* at 2.
86. *Id.*
87. *Id.*
88. 72 Fed. Reg. 69177, 69178 (Dec. 7, 2007).
89. Letter from Aerospace Industries Association (AIA) to DARS (Feb. 4, 2008).
90. *Id.* at 1-2.
91. *Id.* at 2.
92. 75 Fed. Reg. 32642, 32644 (June 8, 2010).
93. *Id.*
94. *Id.*
95. DoD Contract Pricing Committee Report, DFARS Case 2007-D009 (Dec. 24, 2008), at 3.
96. DFARS 252.228-7001(m) (June 2010).
97. Letter from AIA to DARS at 3.
98. *Id.*
99. 75 Fed. Reg. 32642, 32644 (June 8, 2010).
100. *Id.*
101. DCMA Memo at 2.
102. DFARS 252.228-7001(f) (Sept. 1996).
103. *Id.*
104. *Id.*
105. DFARS 252.228-7001(g) (June 2010) (emphasis added).
106. *Id.*
107. This analysis of the GFRC subcontracting-related provisions also reflects discussions with Dr. Douglas N. Goetz, CPPM, CF, GP Consultants, Inc. (former Defense Acquisition University professor).
108. DCMA Memo at 1.
109. DFARS 252.228-7001(f)(5)(v) (June 2010).
110. FAR 42.801, 42.803 (Apr. 2011).
111. FAR 42.709(a)(1),(2) (Apr. 2011).
112. FAR 42.709-1(a)(1) (Apr. 2011).
113. FAR 42.709-1(a)(2) (Apr. 2011).
114. FAR 42.709-1(b) (Apr. 2011).
115. DFARS 252.228-7001(h) (June 2010).
116. U.S. Gov't Accountability Office, GAO-10-331, Unmanned Aircraft Systems: Comprehensive Planning and a Results-Oriented Training Strategy Are Needed to Support Growing Inventories (2010).
117. DFARS 228.370(b)(2)(i)(June 2010); DFARS 252.228-7001(a)(1)(iv) (June 2010).
118. DFARS 252.228-7001(a)(5) (June 2010).
119. Comment on DARS-2007-0077, DCMA Springfield, Picatinny, NJ.
120. GAO-10-331 at 6.
121. 75 Fed. Reg. 32642 (June 8, 2010).
122. *Id.* at 32642-43.