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Toeing The Line On International Cargo Shipments

Law360, New York (July 11, 2011) -- While many practitioners of government procurement law are, by necessity, very familiar with the domestic sourcing requirements found in the Buy American Act, the American Recovery and Reinvestment Act, the Berry Amendment, and the prohibitions associated with the use of nondomestic specialty metals in certain defense contracts, they may not be as familiar with the cargo preference laws and regulations that are applicable to the shipment of military and nonmilitary government-procured goods on vessels.

These laws, the Military Cargo Preference Act of 1904, the Merchant Marine Act of 1936, and the Cargo Preference Act of 1954, can trip up even a seasoned veteran of government acquisition, as the laws are infrequently enforced and impose different requirements on contractors depending on the contractor's status, what agency is procuring the items being shipped and the governmental purpose the items will serve.

Which Requirement Applies

The first thing a contractor contemplating the international shipment of goods in support of a government program must determine is whether a domestic vessel preference will be applicable, and, if so, which one.

While this should be stipulated in the contract that the entity has executed with the government or a higher level contractor, many contracting officers and prime contractors do not know which requirement to apply, so they apply the wrong cargo preference requirement or they apply numerous, conflicting requirements. While such an error may provide a contractor with some relief if the matters becomes the subject of a contract dispute, it still does not absolve the contractor from the laws' requirements.

The Military Cargo Preference Act

In 1904, Congress for the first time imposed a U.S.-flag vessel requirement through the Military Cargo Preference Act, but it only imposed the requirement on military cargo shipments. This requirement, as amended, requires 100 percent of applicable cargo to be carried on U.S.-flag vessels. The law states, "Only vessels of the United States or belonging to the United States may be used in the transportation by sea of supplies bought for the Army, Navy, Air Force, or Marine Corps." 10 U.S.C. § 2631(a).

Based on this language, it's wise to determine for whom or for what the contracted goods are being bought before conceding the requirement applies. For example, a contract awarded by the Army to provide supplies of the Afghan National Army, which is not an unusual scenario, is not a contract purchasing goods for one of the branches of the military and thus outside the scope of this provision.

In fact, Defense Federal Acquisition Regulation Supplement (DFARS) § 247.570(c) specifically excludes "[p]roducts obtained for contributions to foreign assistance programs" and "[p]roducts owned by agencies other than DoD, unless the products are clearly identifiable for eventual use by DoD" from being within the scope of its shipping requirements.

The law also contains a number of exceptions, which are addressed in the DFARS provisions. A contractor may seek an exception to the requirement because: (1) no U.S.-flag vessels are available; (2) the proposed freight charges to the government, the contractor, or any subcontractor are higher than charges for transportation of like goods to private persons; or (3) the freight charges proposed by U.S.-flag carriers are excessive or otherwise unreasonable. DFARS § 247.573-1(c).

If a contractor believes one of these exceptions applies, it should inform the contracting officer as soon as possible, and "at least 45 days prior to the sailing date necessary to meet its delivery schedules," as approval authority for waivers based on these exceptions rests with individuals far above the contracting officer level. DFARS § 252.247-7023(d).

For example, if a contractor contends the shipping rates of U.S.-flag carriers are excessive and/or unreasonable, the contracting officer must determine whether the rates will cause "extraordinarily inefficient circumstances" and result in "excessive [carrier] profits," and "excessive costs to the Government … beyond the economic penalty normally incurred by excluding foreign competition." DFARS § 247.573-1(c)(3). If such a determination is made, the contracting officer then will have to get her findings approved by numerous higher level authorities before the requirement will be rescinded.

If no exception applies, a contractor entering most DoD supply contracts will be required to use U.S.-flag vessels when transporting the supplies by sea. DFARS § 252.247-7023(b)(1). Likewise, prime contractors are required to flowdown to their subcontractors an almost identical requirement, the only exception being the requirement does not apply to the shipment of commercial items by a subcontractor to which the subcontractor adds value and does not serve as a mere distributor. DFARS § 252.247-7023(b)(2).

It is important for a prime contractor to ensure the requirement is included and accurately stated in its subcontract agreements. It is equally important for a subcontractor to carefully review each subcontract agreement that it enters to ensure a prime contractor has not placed on it a burden that exceeds what is required by law and regulations.

Finally, in order to get final contract payment, a contractor must provide with its final contract invoice “a representation that to the best of its knowledge and belief” it has complied with U.S.-flag vessel requirements. DFARS § 252.247-7023(f). Thus, a failure to adhere to the requirements could result in both a downward equitable adjustment to the contract and an allegation that the contractor has made a false claim(s). DFARS § 252.247-7023(g).

The Merchant Marine and Cargo Preference Acts

Through the Merchant Marine Act of 1936, as amended and expanded by the Cargo Preference Act 1954, Congress expanded the requirement to use U.S.-flag vessels in connection with government shipments beyond the transportation of military supplies. These laws, as amended, require that at least 50 percent of the gross tonnage of all government-generated cargo be transported on privately owned, U.S.-flag commercial vessels to the extent such vessels are available at fair and reasonable rates. 46 U.S.C. § 55305. This requirement increases to 75 percent for certain agricultural shipments. 46 U.S.C. § 55314.

These are broad requirements, as they apply to most shipments not covered by the Military Cargo Preference Act, including: (1) all supplies owned by the government, whether possessed by the government, a contractor, or a subcontractor at any tier; (2) supplies to be used by the government that are contracted for but are not owned by the government at the time of shipment; and (3) supplies not owned by the government at the time of shipment that are to be paid for using U.S. currency and funds and transported under the auspices of a Federal foreign assistance program. FAR § 47.503(a).

In fact, the only significant exception to these requirements is that they are inapplicable to subcontracts for the acquisition of commercial items or commercial components, so long as the subcontract is not limited to the mere distribution of commercial items (i.e, if the contract requires nothing more than the reselling of commercial items to the government with no value being added to the commercial items, then the requirement still applies). FAR § 47.503(d).

Even if applicable, the commercial item/commercial component subcontract exception is limited, as the exception does not apply to subcontracts for ocean transportation services or construction contracts, or to shipments in direct support of: (1) U.S. military contingency operations or exercises, or (2) forces deployed in connection with United Nations or NATO humanitarian or peacekeeping operations. FAR § 47.503(d)(3)-(4).

Finally, to ensure contractor and subcontractor compliance with these requirements, the standard FAR clause inserted in contracts in which international shipments may occur requires the prime contractor to submit to the contracting officer and the Maritime Administration copies of all applicable bill of lading statements within 20 to 30 working days of the shipment occurring. FAR § 52.247-64(c)(1).

Conclusion

Every contract that potentially requires the shipment of ocean-borne cargoes as a direct result of federal government involvement may have a contractual requirement that such shipping be done entirely or partly by U.S.-flag vessels. This requirement also extends to many contracts that only have an indirect connection to the government, such as when there is financial sponsorship of a federal program or when the government provides a loan guarantee.

While it is easy to gloss over the myriad terms and conditions found in such a federal contract or subcontract, it is important to determine early in the process if any cargo shipment restrictions are present. If there are, one should ensure they are being imposed correctly and in accordance with the regulations, and, if so, that only the one applicable clause has been incorporated into the contract.

Finally, the contractor should determine how the requirement will impact its overall contract costs at the front-end of the process, to avoid finding out after the contract has closed that most of its anticipated profits were lost to unexpected shipping costs.

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