

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 2147]
November 30, 1940.]

FINANCING THE NATIONAL DEFENSE PROGRAM

*To All Banking Institutions in the
Second Federal Reserve District:*

In order that the productive facilities of the nation may be more fully utilized in the National Defense Program and in order that the smaller business concerns of the country may more generally participate in the program, the National Defense Advisory Commission has designated the Coordinator of National Defense Purchases, Donald M. Nelson, as Director of Small Business Activities. To decentralize its work in these fields, the Commission has asked the Board of Governors of the Federal Reserve System to act as its operating agent. The Board of Governors has designated Governor Ernest G. Draper to supervise these activities of the Reserve System, and to serve as its liaison officer with the Director of Small Business Activities.

In each Federal Reserve Bank and Branch, an officer has been designated by the Federal Reserve Banks to serve as the field representative of the Director of Small Business Activities and of the Board of Governors. The officers designated for this purpose in this District are Leslie R. Rounds, Vice President, and Arthur Phelan, Assistant Vice President, at New York, and Reginald B. Wiltse, Assistant Manager, at Buffalo. These officers will be glad to confer with business men and bankers concerning the procedure to be followed in obtaining Government contracts and subcontracts, and also concerning means of obtaining needed credit, in those cases where credit may not be available from the usual sources. For your convenience, there is included in the following pages information regarding Government contracts for supplies and plant facilities. Additional copies of this circular will be furnished upon request.

The office of the Director of Small Business Activities will serve as a clearing house for information for the National Defense Advisory Commission and the War and Navy Departments, as well as for smaller business enterprises. It will endeavor to assist business men to learn of the future needs and requirements of the military and naval branches of the Government. At the same time it will endeavor to assist primary contractors who have been awarded defense orders to get in touch with other business enterprises which may be able to furnish special types of goods and services required by the primary contractors. The Director of Small Business Activities also desires to promote the use of customary banking channels in financing the credit needs of the small business enterprises that participate in meeting the requirements of this program.

One immediate step requiring your cooperation is suggested. Among your customers, or in your community, there are no doubt concerns which are not yet on the invitation bidding lists of the local Army procurement officers, or of the Navy Department or other branches of the armed service. It is the purpose of the present inquiry to obtain such information regarding these concerns as would be pertinent to their possible participation in the national defense program. A sample report form indicating the data you are asked to secure is enclosed. The information called for is brief, but it is desired to have it as accurate as possible, and it is expected that you will obtain from the individual concerns any information which you are otherwise unable to furnish readily. It is hoped that your cooperation in furnishing this information will make possible the participation by some of these concerns in the production program for national defense. We shall be glad to furnish you with an additional supply of report forms after you have estimated your requirements. Information with respect to concerns which are already on the invitation bidding lists of the local Army procurement officers, the Navy Department or other branches of the armed service should not be supplied to us.

It is possible that we may be asked, from time to time, to assist in securing other information as to sources of supply of articles which may be in demand but whose known sources of supply are inadequate. If there are any concerns in your area which you feel may be particularly qualified, because of technical ability or equipment, to fill what might be unusual needs of the defense program, we shall be glad to have you advise us in detail concerning them and their facilities. This may be done by writing such comments as you may wish on the back of the report forms which we will supply to you.

It is our hope that you will actively participate in this endeavor to further the national defense program and that you will not hesitate to call upon this bank or its Buffalo Branch for any assistance which we can give to you.

GEORGE L. HARRISON,
President.

FINANCING THE NATIONAL DEFENSE PROGRAM

*For the Information of Banking Institutions and
Industrial Enterprises in the Second Federal Reserve District.*

It is the purpose of this circular to make available to banks and their customers, especially the smaller business concerns, information concerning the national defense program and the opportunities for participation in that program.

Banking institutions in this district, as well as elsewhere, are in a position to assure an adequate supply of credit for the needs of the national defense program, and it is expected that the program will be largely financed through the extension of such credit as a result of negotiations directly between prospective borrowers and their banks.

Contracts Assignable as Security

Heretofore, one of the principal difficulties in financing defense production with private funds, has been the prohibition against the assignment of unallowed claims under contracts with the United States. This obstacle has recently been removed by an act of Congress.

The Assignment of Claims Act of 1940, approved October 9, 1940, was enacted to assist in the national defense program by facilitating the construction and expansion of industrial plants and the production of defense materials with the aid of private capital and credit. It was sponsored by the National Defense Advisory Commission after consultation with the Army and Navy Departments.

The Act provides that moneys due or to become due from the United States, or from any agency or department thereof, under a contract providing for payments aggregating \$1,000 or more, may be assigned to a bank, trust company, or other financing institution, including any Federal lending agency, subject to three general limitations:

- a. No claim under a contract entered into prior to the date of approval of the Act may be assigned without the consent of the head of the department or agency concerned.
- b. No claim under a contract entered into after the date of approval of the Act may be assigned if it arises under a contract which forbids such assignment.
- c. *Unless otherwise expressly permitted by the contract*, an assignment shall cover all amounts payable under the contract and not already paid, shall not be made to more than one party, and shall not be subject to further assignment, except that it may be made to one party as agent or trustee for two or more parties participating in the financing.

The assignee is required to file a written notice of the assignment together with a copy of it with the Government's (a) General Accounting Office, (b) contracting officer or the head of his department or agency and (c) disbursing officer, if any, designated in the contract to make the payments under the contract, and also with the surety or sureties upon the bond or bonds, if any, in connection with the contract.

Under the terms of the Act, additional protection may be afforded the lender of funds in that, if so provided in any contract entered into by the War or Navy Departments, payments to an assignee of any claim arising under such contract shall not be subject to reduction or set-off for any indebtedness of the assignor to the United States arising independently of the contract.

Procedure In Connection With Assignments

I. Consent to Assignment of Claims upon Contracts dated *prior* to October 9, 1940.

The Assistant Secretary of War is the proper head of department to give consent to an assignment of claims resulting from contracts entered into with the War Department prior to October 9, 1940. To obtain such consent, the contracting company should make request to the "contracting officer" who will submit it to the "chief of arm of service" concerned, who will then submit it to the Assistant Secretary of War.

The Secretary of the Navy is the proper head of the department to give consent to the assignment of claims resulting from contracts entered into with the Navy Department prior to October 9, 1940. To obtain such consent, the contracting company should make request to the "Bureau of Supplies and Accounts", Navy Department, Washington, D. C.

The request in respect of contracts with either Department should include:

- (1) Name of contractor
- (2) Contract:
 - (a) Number
 - (b) Date
 - (c) Amount
- (3) Institution to which assignment is contemplated
- (4) Any confidential feature of the contract.

A copy of the instrument of assignment should accompany the request.

II. Consent to Assignment of Claims upon Contracts dated *subsequent* to October 9, 1940.

Claims resulting from contracts entered into subsequent to October 9, 1940, may be assigned without approval of either of the above described heads of departments, unless the terms of the contract expressly forbid such assignment.

III. Information concerning Contract Terms

Requests for information regarding

- (1) Prior assignments
- (2) Payments made to a contractor
- (3) Surety bond executions
- (4) Name of surety.

It does not appear feasible to have copies of all executed contracts prepared and certified for possible use of an assignee.

In the case of contracts with the War Department, the request should be made directly to the "contracting officer" and he will supply such information. The War Department suggests that since the "*contracting officer*" may hesitate to divulge information regarding certain contracts without the approval of the contracting company, the lending institution should request such contracting company to authorize the "contracting officer" to furnish the information upon request of the institution. A lending institution may check salient provisions of a contract directly with the "contracting officer."

In the case of contracts with the Navy Department, the request should be transmitted to the "Division of Bank Operations", Board of Governors of the Federal Reserve System, Washington, D. C., which will obtain such information from the "Bureau of Supplies and Accounts", Navy Department. If a lending institution desires to check salient provisions of a contract, it is suggested that it forward a copy of the contract by "air mail", or otherwise, to the "Division of Bank Operations", Board of Governors of the Federal Reserve System, Washington, D. C. Upon receipt, it will be checked immediately and advice concerning its authenticity will be given by wire. The authentic copy of each contract *executed by all parties* is the property of the "General Accounting Office" and delays may result if requests are made to the "General Accounting Office" for photostats of that copy.

Two types of contract will hereafter be the principal basis for contracting with either the War or Navy Department in connection with the defense program; one is for contracts for sales of equipment or supplies to the Government and the other for contracts for the acquisition or construction of plant facilities by the manufacturer.

Contracts for Supplies

Contracts for supplies may be entered into by the Government through the usual method of advertisement and competitive bids, or by negotiation. The latter method is used where it is impracticable or undesirable to make awards on a competitive basis. Where deemed appropriate, as for certain urgent construction contracts, they may be made upon a "cost-plus-fixed-fee" basis.

There are two general types of materials required by the Government under the defense program. The first comprises specialized heavy goods such as naval vessels, airplanes, and tanks and, it will be recognized that facilities available for this type of production are limited. A wide variety of other supplies is needed, however, and a large number of plants of small and medium size are in a position to manufacture these supplies. Many of these plants are already known to and listed by the Government departments concerned, but it is important that none of them be overlooked. The National Defense Advisory Commission desires, in so far as it is practicable, to spread out the production of materials needed for national defense so as to reduce the necessity for providing additional plant facilities and to utilize existing labor at or near places where it is now located. With these purposes in mind and in behalf of the National Defense Advisory Commission, this bank is seeking to obtain information concerning potential suppliers of defense materials in all of the communities of its district by the method set forth on the first page of this circular. The information supplied thereby will be given to the National Defense Advisory Commission in order to minimize the necessity for contractors to go to Washington, either to obtain information concerning prospective contracts or to place bids for such contracts, and it will thus be possible to avoid needless expenditures of time and money.

Subcontractors and suppliers of materials desiring to have a share of the business under defense contracts awarded to others by the Government, may obtain valuable information as to the awards of such contracts from a variety of publications. These include the following:

- U. S. Government Advertiser. Weekly, \$12 a year. 511 Eleventh Street, N. W., Washington, D. C.
- Federal Register. Daily, \$12.50 a year. Superintendent of Documents, Government Printing Office, Washington, D. C.

Division of Public Contracts, Department of Labor, Washington, D. C.—Weekly release on contracts awarded.

Public Relations Branch, War Department, Washington, D. C.—Daily bulletins.

Navy Department, Washington, D. C.—Bulletins covering prime contract awards for construction and supplies.

National Defense Advisory Commission. Press releases covering defense contracts cleared.

Contracts for Plant Facilities

A form of "Emergency Plant Facilities Contract" has been approved by the National Defense Advisory Commission after consultation with the War, Navy and Treasury Departments and the Comptroller General. It provides for the acquisition or construction of plant facilities in order that the contractor may be able to manufacture and deliver supplies under a contract with the Government. It specifies the work to be done, the estimated cost, and the estimated date of completion. For the protection of the contractor, and at the same time to provide a sound means of financing the plant acquisition, construction or expansion, provision has been made in the contract for the reimbursement by the Government to the contractor of the total cost of such plant facilities in sixty monthly installments, following completion of the facilities, subject to acceleration in payment in certain cases such as earlier termination of the contract. Provision is made for the Government to acquire title to the facilities except in so far as the contractor elects to retain them, or any part constituting a complete plant or complete addition, for a price based upon their cost less depreciation, obsolescence and loss of value at the rates specified in the contract, or for a lesser agreed fair value. The contractor may negotiate for a lease, from the Government, of the facilities not retained by the contractor, with or without an option to purchase. The contract allows the assignment of claims under the contract and protects the Government and the lender by requiring proper insurance, replacement and maintenance of the facilities.

Banks and the National Defense Program

Banks can play an important part in the present emergency by financing production and encouraging local business to participate actively in the National Defense Program. In addition to assisting in making prospective Government orders known to local producers and to informing the proper authorities, through the Federal Reserve Bank of their district, of facilities available for production in their localities, it is suggested that the banks familiarize themselves with procedures for obtaining and financing Government contracts. They may be asked by their business customers how to secure defense contracts, and they may be asked to advance funds on the security of such contracts. As the financial agents of their communities, banks are in a favorable position to carry out these functions and thereby to participate effectively in the Defense Program.

Basically, lending on an assigned claim under a plant facilities or supplies contract will be similar to regular commercial lending, either of the working capital or term loan type. Apart from compliance with legal requirements, the important question in the case of assigned claims under either a facilities or a supplies contract is whether the work can and will be satisfactorily completed in accordance with the terms of the contract. The managerial competence of the contractor in estimating and controlling costs, in applying sound financial policies, and in expediting production will be an important element affecting the degree of risk.

The costs of advancing this type of credit will vary with the conditions in each case. Elements affecting the costs to the borrower and the lender will be the amount of investigation which is necessary before credit is advanced, the general character of the security, the capacity and responsibility of the borrower, the legal services entailed, and the amount of service needed on the loan after it is made.

The Emergency Plant Facilities Contract provides a favorable distribution of risk between the Government and the contractor in that it leaves with the contractor the normal risks of production but places with the Government the risk of obsolescence of the facilities and the problem of excessive plant capacity at the end of the emergency.

The Federal Reserve Bank of New York is prepared to assist banks and business concerns in this district, which may be able to contribute to the national defense program, by furnishing them with available information relating to defense contracts. This bank is also authorized, within certain limitations, to make industrial advances for working capital and to participate with commercial banks in making such loans. The Reconstruction Finance Corporation is also authorized to extend or participate in loans to industry, both for working capital and plant expansion. Our immediate objective is to help plants of small and moderate size to participate, as contractors and subcontractors, in the defense program and to facilitate their securing the credit which they may need, whenever credit can be advanced on a sound and reasonable basis.

FACILITIES FOR DEFENSE SUPPLIES

This form should not be filled out for any concern that now receives invitations to bid from the Army, the Navy, or any other branch of the armed services.

TO THE FEDERAL RESERVE BANK OF NEW YORK

1. Name of concern.....
2. Address of concern.....
(Street) (City) (State)
3. State principal articles or products now manufactured or processed.....
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.....
4. What kinds of defense articles would the concern be interested in supplying?
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.....
.....
5. State approximate or estimated number of persons employed
6. (a) State the total approximate value of sales for the year 1939
- (b) At what per cent of maximum capacity did concern operate in 1939?
- (c) At what per cent of maximum capacity is concern now operating?
7. If the concern should obtain a defense contract in reasonable relation to present or expandable capacity, would it require additional financial aid for—
(a) Working capital purposes?
- (b) Fixed capital purposes?
8. Could reasonable financial aid be obtained from local banks?

.....
Name of bank submitting report

.....
Signature of officer

PLEASE TYPE ANSWERS

(Note: This form should be filed in triplicate with the Federal Reserve Bank of New York.)

R-730c

FACILITIES FOR DEFENSE SUPPLIES

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7. If the concern should obtain a defense contract in reasonable relation to present or expandable capacity, would it require additional financial aid for—
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Name of bank submitting report

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Signature of officer

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R-730e

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TO THE FEDERAL RESERVE BANK OF NEW YORK

1. Name of concern.....
2. Address of concern.....
(Street) (City) (State)
3. State principal articles or products now manufactured or processed.....
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4. What kinds of defense articles would the concern be interested in supplying?
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