VICKERS
PL 1

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

18975

B-107871 July 31, 1981

The Honorable John C. Danforth
Chairman, Subcommittee on Federal
Expenditures, Research and Rules
Committee on Governmental Affairs
United States Senate

Dear Mr. Chairman:

This is in response to your request of July 10, 1981, for our comments on H.R. 1371, an act to amend the Contract Disputes Act of 1978 (Pub. L. No. 95-563).

The bill is to amend section 12 of the act concerning the payment of interest on amounts found due contractors on claims.

The first change substitutes "January 1, 1981, and ending on June 30, 1981," for "July 1, 1979, and ending on December 31, 1979." This change will merely have the act reflect the current 6-month period for the computation of interest. The second change, which requires no substantive comment, deletes the reference in the act to the Renegotiation Board because of its abolishment and makes clear that the Secretary of the Treasury is to establish the rate of interest payable on claims every 6 months and publish each rate in the Federal Register. Both of these changes follow suggestions contained in correspondence from our Office, dated April 10, 1979, and March 3, 1981, to the House Committee on the Judiciary.

The other change to the bill involves the manner in which interest will be paid to contractors. When we first recommended this legislation (B-197871, April 10, 1979, reprinted in H.R. Rep. No. 97-47 at page 6), our proposed bill specified that "Interest with respect to a particular claim shall be paid at

014735

the rate determined pursuant to this section for the period which includes the date on which interest begins to run." For purposes of discussion, we will refer to this as the "fixed-rate method." Under the fixed-rate method, the interest rate, once established with respect to a particular claim, would remain the same throughout the life of that claim. In other words, each new 6-month rate set by the Treasury Department would apply only to new claims filed within that 6-month period.

In H.R. 1371, as reported by the House Judiciary Committee and passed by the House of Representatives, the last sentence has been changed to provide that interest shall be payable "at the rates determined pursuant to this section for the period which includes the date on which interest begins to run and each six-month period thereafter." Under this approach, which we shall refer to as the "variable-rate method," interest on a particular claim would have to be computed separately for each 6-month period or fraction thereof until the claim is paid. Each new 6-month rate set by the Treasury Department would retroactively affect all pending claims. We assume the variable-rate method was substituted at the request of the Office of Federal Procurement Policy (OFPP), which had expressed preference for it in informal discussions with our staff.

While we would concur that the method of application should be clarified in the legislation, we fail to see any advantage to the variable-rate method proposed by OFPP. In our opinion, the fixed-rate method is preferable for several reasons:

(1) The variable-rate method is inconsistent with prevailing commercial practice.

(2) The variable-rate method is inconsistent with legislative and administrative precedent.

(3) The variable-rate method will cause increased Federal expenditures with no demonstrable benefit.

(4) The variable-rate method will be more administratively burdensome with no offsetting advantage.

We will discuss each of these briefly in sequence.

Commercial practice. The purpose of authorizing interest is to compensate a claimant for the loss of his funds. If a contractor has to borrow money to continue operating while a claim is pending, he will have to pay interest on that loan. Also, when a claim is allowed, the impact on the contractor in economic terms is that the Government has, in effect, "borrowed" money from him. With the exception of a few home mortgage schemes of very recent vintage, interest in the commercial world is and always has been applied on a fixed-rate basis. We see no reason for the Government to operate any differently.

Legislative and administrative precedent. When we made our original proposal in 1979, we took the sentence establishing the fixed-rate method, quoted above, directly from the Renegotiation Act. See 50 U.S.C. App. § 1215(b)(2), as added by Pub. L. No. 92-41, 85 Stat. 97. Under the Renegotiation Act, it was clear that interest was to be applied on a fixed-rate basis. For example, in reporting on the bill which became Pub. L. No. 92-41, the Senate Finance Committee stated "The interest rate once determined in this manner with respect to any specific excessive profits determination is to continue unchanged thereafter with respect to those excessive profits." S. Rep. No. 92-245, 92d Cong., 1st Sess. 6 (1971). The same statement is found in the report of the House Committee on Ways and Means. See H.R. Rep. No. 92-235, 92d Cong., 1st Sess. 6 (1971). Since the Contract Disputes Act of 1978 incorporated the rate used under the Renegotiation Act, and since there was no indication of congressional intent to the contrary, it seemed (and still seems) logical to us to look to the Renegotiation Act for the method of application as well.

Several decisions of boards of contract appeals support the fixed-rate approach. The Corps of Engineers Board of Contract Appeals, in Select Contractors, Inc., ENG BCA Nos. 3855 and 3919, 79-2 BCA Para. 14,155 (1979), stated:

> "The Board is aware of a body of opinion that the rate applied to any single equitable adjustment should change from time to time to reflect the current rate established by the Secretary of the Treasury for each successive six month period. The Board does not share that opinion. * * * The rate is based on five year loans, not successive six month loans. The use of a single rate does not automatically favor either contractors or the government * * *. In fact, the rate has descreased several times (though its overall trend has been to rise), so a single rate does not necessarily result in a lesser amount of interest."

While this decision did not directly involve section 12 of the Contract Disputes Act, it construed language in a contract provision identical to section 12. The General Services Administration Board of Contract Appeals has used the fixed-rate method in applying section 12. Capital Electric Co., GSBCA Nos. 5316 and 5317, 81-1 BCA Para. 15,001 (1981); Schindler Haughton Elevator Corp., GSBCA No. 5390, 80-2 BCA Para. 14,671 (1980). In addition, this Office has thus far consistently applied the fixed-rate method in certifying board awards for payment under the Contract Disputes Act.

A similar interest structure has recently been adopted for claims by the Government. The Treasury Department's Fiscal Requirements Manual (Vol. I, chapter 8000, sec. 8020.20) no longer sets a specific interest rate for debt claims but now provides that interest on indebtedness to the Government should be charged at a rate to be set by the Treasury Department quarterly. Although this new system has not yet been fully implemented, the Treasury Department has advised us that it views it--and we agree--as a fixed-rate charge, that is, the rate will not change each 3 months with respect to a particular debtor. We see no reason to apply a different method to payment claims than is applied to debt claims.

(As one possible exception, the Internal Revenue Service (IRS) may be varying the interest rate it charges to delinquent taxpayers, but the IRS rate is revised only at 2-year intervals.)

Federal expenditures. As a general proposition, given two possible alternatives, we would favor the alternative that results in lower Federal expenditures unless it can be shown to be patently unfair. As the Engineering Board noted in Select Contractors, Inc., supra, the interest rate will rise over the long term because the trend of the American economy is inflationary. Thus, the variable-rate method will, over the long term, result in increased Federal expenditures.

However, any argument that the variable-rate method is somehow more "equitable" will not withstand scrutiny. Two simple examples will illustrate. The rates for three recent periods were as follows:

July 1, 1979 - December 31, 1979 -- 10-1/4 percent
January 1, 1980 - June 30, 1980 -- 12-1/2 percent
July 1, 1980 - December 31, 1980 -- 10-1/2 percent

Example 1: Claim is filed in July 1979 and paid in June 1980. Contractor would receive more interest under the variable-rate method.

Example 2: Claim is filed in January 1980 and paid in December 1980. Contractor would receive more interest under the fixed-rate method.

Thus, neither method can be shown to produce higher or lower interest payments on a case-by-case basis, although, as noted, the variable-rate method will produce higher total interest payments over a long term (based, of course, on the assumption that the trend in the economy will continue to be inflationary at least to some degree). Therefore, unless one equates "equity" with increased Federal expenditures, it seems clear that the variable-rate method cannot be shown to be inherently any more "equitable."

Ease of administration. We think it is apparent that a fixed-rate method will be much easier to administer and will, therefore, both expedite payments and reduce the administrative costs of processing the payments. Again, given two alternatives, we favor the one that will minimize administrative burden unless it is demonstrably unfair, which is not the case here.

In sum, the fixed-rate method will save the Government money, will be easier and, therefore, less expensive to administer, and is consistent with commercial practice and with legislative and administrative precedent. We see no conceivable advantage to the variable-rate method and recommend, therefore, that the committee amend H.R. 1371 by changing the last sentence to read "Interest with respect to a particular claim shall be paid at the rate determined pursuant to this section for the period which includes the date on which interest begins to run."

Finally, while not directly involved in the proposed amendments, you requested our views concerning the portion of report No. 97-47 (attached to your letter of July 10, 1981) which notes that questions have arisen regarding from what date interest is payable on a claim of over $50,000. The report concludes that interest on such claims begins when the claim is received under section 6(a) of the act by the contracting officer, not when the claim is certified by the contractor. Section 6(c) requires all claims over $50,000 be certified by the contractor that the claim is made in good faith, the supporting data is accurate and complete and the amount requested accurately reflects the contract adjustment for which the contractor believes the Government liable.

Section 12 of the act states that interest shall be paid from the date the contracting officer receives the claim pursuant to section 6(a). The first sentence of section 6(a) reads as follows:

> "All claims by a contractor against the government relating to a contract

> shall be in writing and shall be
> submitted to the contracting officer
> for a decision."

Based on our reading of the act's provisions, we disagree with the view expressed in the report that interest on uncertified claims over $50,000 begins to run when the claim is received by the contracting officer. The committee has cited no legislative history requiring this interpretation and we have found none to support such a conclusion. A claim of over $50,000 cannot be paid until it has been certified by the contractor under section 6(c). Therefore, the claim has not been submitted to the contracting officer <u>for a decision</u> until certified because it is not a complete claim ready for adjudication by the contracting officer.

Also concern has been expressed that a contractor may not have all the necessary supportive data available to satisfy the certification requirement when he initially notifies the agency of the claim in writing. We see no injustice to the contractor. If the contractor does not have all the necessary data available to satisfy the certification requirement when it initially notifies the contracting officer of the claim in writing, we do not think the Government should be required to pay interest on the claim. This is consistent with the general rule of law that interest becomes due and payable when the underlying debt or principal becomes due and payable and not before. 47 C.J.S. Interest § 26 (1946).

If the committee is concerned about unreasonable demands by the contracting officer for supplemental data, we believe that demands are required to be reasonable under the act. The validity of these demands could be reviewed by a board upon appeal and, if found to be unreasonable, the board could award interest from the date it found the contractor reasonably met the certification requirement.

In this regard, we believe the Department of Defense position as expressed in Defense Acquisition Regulation § 1-314(j) reflects the proper interpretation of the act that interest does not run on a claim over $50,000 until the claim has been properly certified.

We appreciate being given the opportunity to express our views.

Sincerely yours,

Milton J. Socolar

Acting Comptroller General
of the United States