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From the Editors

In this issue of the *Adviser*, we respond to several questions provoked by previous articles—for example, the Note by Robert L. Higgins on the timing of weekend return travel, and the Comment that discusses the recent significant change in the cover for GAO draft audit reports.

We trust that you will find these followups useful, and we believe the articles are in keeping with the central purpose of the *Adviser*—to anticipate and respond to your needs.

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APPROPRIATIONS: A BASIC LEGAL FRAMEWORK - PART II

Henry R. Wray[1]

This is the second part of a two-part article on Federal appropriations. Part I, which appeared in the last issue of the Adviser, *discussed the appropriations process in general terms. In this Part, Mr. Wray deals with major questions concerning the use, or "availability," of appropriations in specific contexts, i.e., whether a particular obligation or expenditure is legal under the appropriation involved.—Eds.*

Questions concerning the availability of appropriations comprise the main body of "appropriations law," which has developed largely from GAO decisions. These questions can be divided into two main categories: (1) availability as to time and (2) availability as to purpose.

Availability As To Time

As indicated in Part I of this article, some appropriations are enacted on either a permanent or "no-year" basis and, therefore, do not present significant timing problems. However, most appropriations are made available for a fixed period of time. The period of availability is almost always clear from the face of the appropriation act. The regular appropriation acts for each year normally contain a "general provision" stating that all appropriations made therein are available only for the current fiscal year unless otherwise provided in the act.

The principle that 1-year appropriations can be used only during the fiscal period for which they are made was reflected in the first general appropriation for the Government, enacted in 1789 "for the service of the present year* * *"[2] and is now codified as follows:

> "Except as otherwise provided by law, all balances of appropriations contained in the annual appropriations bill and made specifically for the service of any fiscal year shall only be applied to the payment of expenses properly incurred during that year, or to the fulfillment of contracts properly made within that year."[3]

Concept of obligations. The two basic uses of appropriations are expenditures (disbursements) of funds and the incurring of "obligations" against an appropriation to be liquidated by disbursement at a later time. The extent to which an agency is able to take advantage of an appropriation is thus measured by the amounts actually paid out during its availability period plus amounts obligated but not disbursed within that period. Conversely, appropriation amounts not so used within the availability period are returned to the Treasury and thereby "lost" to the agency. In view of these consequences, the concept of "obligation" is central to the time availability of appropriations.

Section 1311 of the Supplemental Appropriation Act, 1955,[4] specifies criteria which must be met to record appropriation obligations. This section was enacted (as permanent legislation) to prevent agencies from applying overly broad theories of "obligation" and thereby minimizing the amount of appropriations "lost."[5] Section 1311(a) lists obligation criteria by the types of appropriation transactions involved. For example, it states that obligations under contracts must be supported by documentary evidence of

> "a binding agreement in writing between the parties thereto, including Government agencies, in a manner and form and for a purpose authorized by law, executed before the expiration of the period of availability for obligation of the appropriation or fund concerned for specific goods to be delivered, real property to be purchased or leased, or work or services to be performed * * *."

[1] Deputy Assistant General Counsel (General Government Matters), Office of the General Counsel, GAO.
[2] 1 Stat. 95.
[3] 31 U.S.C. §712a (1970).
[4] 31 U.S.C. §200 (1970).
[5] 51 Comp. Gen. 631, 633 (1972).

Once a valid obligation is incurred against an appropriation—whether by contract, grant, or otherwise—the full amount of the obligation is payable from that appropriation, even if payments are not completed until well after the appropriation expires.[6] Thus, care must be taken to assure that amounts available in the appropriation charged will be sufficient to cover the full obligation, particularly under "cost" contracts and other transactions where the full amount required is not certain at the time the obligation is made.[7]

Bona fide needs. Another important concept concerning the time availability of appropriations is the *bona fide* needs rule. Consistent with 31 U.S.C. § 712a, quoted previously, this rule provides that, in order to obligate a fiscal year appropriation where payments will be made in a succeeding year, the obligation must be for a purpose which satisfies a *bona fide,* or genuine, agency need existing during the year in which the obligation is made.[8] Thus, where an agency has a continuing need for certain supplies or services, a contract made in fiscal year 1977 can only cover supplies or services needed in that year.[9] Determination of what constitutes a *bona fide* need depends largely on the facts of each case. For example, an agency can contract for materials for which it has an existing need in fiscal year 1977 even though, because of production schedules, the materials will not actually be delivered within that year.[10]

Availability As To Purpose

Every appropriation obligation or expenditure must, of course, be for a purpose within the scope of the appropriation.[11] However, there are very few hard and fast rules applicable to the many questions which arise concerning the availability of appropriations as to purpose. The following general principles may be useful in some cases, but are rarely dispositive:

—An appropriation for a specific object is available for that object to the exclusion of a more general appropriation that might otherwise by considered available for the same object. *E.g.,* 38 Comp. Gen. 758, 767 (1959).

—Where two appropriations are equally available for a particular object, the agency has discretion to decide which one to use, but, thereafter, continued use of the same appropriation is required. *E.g.,* 23 Comp. Gen. 827 (1944).

—The availability of an appropriation cannot be expanded or otherwise changed through transfer to a working fund or similar device. *E.g.,* 26 Comp. Gen. 545, 548 (1947).

—Appropriations are available to fund additional duties imposed on an agency by legislation enacted after the appropriation where the new duties are within the general framework of the appropriation. *E.g.,* 46 Comp. Gen. 604 (1967).

Also, a number of statutory provisions and GAO decisions establish certain purposes for which appropriations are generally *not* available. The following listing is illustrative but by no means exclusive:

—No advance of public money may be made unless authorized by the appropriation concerned or other law. 31 U.S.C. § 529 (1970). *See, e.g.,* 42 Comp. Gen. 659 (1963); *cf.,* 48 Comp. Gen. 784 (1969).

—No appropriation to any Government corporation or agency may be used for publicity or propaganda designated to support or defeat legislation pending before the Congress. (Based on a "general provision" carried in the annual Treasury, Postal Service, and General Government Appropriation Act.) *See,* B-178648, September 21, 1973.

—Appropriated funds may not be used to furnish personal gifts, benefits, or services to individuals. *E.g.,* 55 Comp. Gen. 932, 935-36 (1976); 55 Comp. Gen. 346 (1975); 53 Comp. Gen. 770 (1974).

—In view of the Federal Government's constitutional immunity, appropriations are not available to pay State taxes where the incidence of the tax is on the United States. *E.g.,* 55 Comp. Gen. 1358 (1976).

[6] *See, e.g.,* 55 Comp. Gen. 768, 773 (1976); 50 Comp. Gen. 589, 591 (1971). This rule derives from the following statutory provisions: 31 U.S.C. §§200(d), 712a and 702 (1970).

[7] *See,* 34 Comp. Gen. 418 (1955).

[8] B-183184, May 30, 1975; 38 Comp. Gen. 628 (1959).

[9] 33 Comp. Gen. 90, 92 (1953).

[10] 37 Comp. Gen. 155, 159 (1957).

[11] 31 U.S.C. §628 (1970).

—Appropriated funds may not be used to furnish telephone services in private residences. 31 U.S.C. §679 (1970); *see, e.g.*, B-175732, May 19, 1976; *cf.*, 53 Comp. Gen. 195 (1973).

—Under the policy of the United States to assume its own risks of loss, appropriations are not available to procure insurance. *E.g.*, 35 Comp. Gen. 391 (1956); *cf.*, 55 Comp. Gen. 1343 (1976).

However, few of the principles stated above are absolute in their application to particular contexts, as an examination of the accompanying cases will reveal.

Statutory interpretation; legislative history and its limitations. In the absence of a controlling general statutory provision or firmly established rule, questions concerning the use of appropriations must be approached as a matter of statutory construction. This requires review of the language of the appropriation act and, in most cases, the authorization act that the appropriation implements. The legislative histories of the relevant statutes must also be considered. This includes the congressional committee reports, committee hearings, and floor debates in each House of Congress.[12]

The testimony and documentary materials presented during hearings before the Appropriations Committees are frequently valuable in ascertaining the agency's understanding, as disclosed to the Committees, of how proposed appropriations will be used. Such presentations may turn out to be decisive in determining whether a particular use of funds is legal. For example, the use of funds under a longstanding agency practice which is known to the Congress may in some cases be considered to come within the scope of the current appropriation, even if it is not expressly provided for by the statute.[13]

However, beware of treating all congressional statements made in connection with an appropriation bill (or any other bill, for that matter) as controlling "legislative history." As discussed in Part I of this article, the legislative record of an appropriation bill may contain statements, or even "instructions," as to the use of lump-sum appropriations which cannot be construed as explaining the statutory language itself. While these expressions may be relevant to nonstatutory reprogramming requirements, they do not constitute legislative history for purposes of determining the agency's authority under the statute in a strict legal sense.[14]

Concept of "necessary expenses." It often happens that there is no statutory provision, established rule, or legislative history to assist directly in resolving a particular appropriations question. In these cases, the question usually comes down to whether the use of funds can be considered a "necessary expense," *i.e.*, is it for a purpose that reasonably may be viewed as serving the general objectives for which the appropriation statutes were enacted?

All uses of funds must, of course, be "necessary" in this sense. However, the concept of "necessary expense" operates as a practical matter to emphasize the discretion of each agency to use its funds, within reasonable bounds, in a manner that it considers appropriate and desirable. Thus, for purposes of deciding the legality of an expenditure, GAO need not determine that the agency's use of funds is the only way to accomplish a particular purpose, or even the best way; it is enough that the agency's determination of appropriateness is reasonable under the circumstances and not violative of an affirmative prohibition.[15]

The necessary expense principle generally allows agencies to use funds for any purpose incident to their statutory functions. For example, a Federal regulatory agency's responsibility to make determinations on the basis of a full and fair presentation of issues justifies the use of its appropriations to reimburse the expenses of parties and intervenors in proceedings before it where their inputs could not otherwise be obtained.[16] Likewise, the use of appropriated funds to install central air conditioning in the home of a disabled veteran is proper incident to a statutory program designed to emphasize and facilitate non-hospital-based medical care.[17]

As indicated by its title, this article is designed to present no more than an outline of appropriations matters from a legal viewpoint. While the article only scratches the surface, it will, hopefully, provide some insight into the basic approaches which GAO applies to appropriation questions.

[12] The Office of the General Counsel has published a "Legislative Research Guide," written by former Assistant General Counsel James Masterson, which describes sources and techniques for review of legislative history. Copies may be obtained from the GAO Distribution Section.

[13] *See*, 28 Comp. Gen. 296, 298 (1948); 26 Comp. Gen. 545, 547 (1947); *compare*, 18 Comp. Gen. 533 (1938).

[14] *See, LTV Aerospace Corp.*, 55 Comp. Gen. 307, 315-326 (1975). For recent applications of the "LTV principle," *see also*, 55 Comp. Gen. 812 (1976); B-177610, September 3, 1976; B-186818, September 22, 1976.

[15] *See*, 50 Comp. Gen. 534, 536 (1971); *cf.*, 55 Comp. Gen. 1076 (1976).

[16] *See, e.g.*, B-139703, September 23, 1976.

[17] 53 Comp. Gen. 351 (1973). The following recent cases further illustrate the "necessary expenses" concept: 55 Comp. Gen. 800 (1976); 51 Comp. Gen. 797 (1972); 50 Comp. Gen. 128 (1970); *compare*, 53 Comp. Gen. 71 (1973); 52 Comp. Gen. 504 (1973).

GAO AND THE FREEDOM OF INFORMATION ACT -- PART I

Robert Allen Evers[1]

The Freedom of Information Act (FOIA) was signed into law by President Johnson on July 4, 1966.[2] It went into effect one year later—July 4, 1967. Almost from the start, the courts liberally construed the act by favoring disclosure of public records, largely in recognition of the strong congressional policy inherent in the act. More recently, Congress has again spoken on the subject—by amending the act in 1974[3] to strengthen its provisions substantially. Because of these recent amendments, there remains little doubt that the Congress wants the fullest possible public disclosure of information in the hands of executive branch agencies.

Because the General Accounting Office is a part of the legislative branch, the act does not apply to GAO.[4] But that does not mean the act is of no interest or concern to GAO. Quite the reverse is true. *First,* GAO records in the hands of executive branch agencies *may* be subject to FOIA requests made to that agency. One aspect of that problem—confidentiality of draft audit reports—is dealt with in the Comment on page 6 of this issue of the *Adviser. Second,* GAO itself frequently receives freedom of information type requests. This is where audit personnel are most likely to become involved in the freedom of information area.

Although GAO is not subject to FOIA, the Comptroller General has declared that it is GAO's policy "to make the fullest possible disclosure of information consistent with our responsibilities as an agency of the Congress."[5] This policy was first set out in a memorandum to heads of divisions and offices on July 3, 1967, the day before the act became effective for executive branch agencies. In January 1968, regulations regarding "Public Availability of GAO Records" were published in the Federal Register.[6] These regulations are still in effect, and they appear at title 4, Code of Federal Regulations, Part 81. They are implemented by GAO Operations Manual Order No. 1330.1, January 15, 1974.

These regulations have three noteworthy features:

1. Their key terms parallel the provisions of the FOIA as originally passed.
2. They recognize GAO's unique status as an agency accountable to the Congress, but do not specify the consequences of this uniqueness.
3. They have not been amended to reflect the 1974 FOIA amendments.

Since the passage of the 1974 amendments to the act, public awareness of the right to demand access to Government records has increased enormously. This, in turn, has resulted in a dramatic increase in freedom of information type requests to GAO, generally for access to (1) audit work papers and draft reports, (2) congressional correspondence, and (3) records supporting Comptroller General decisions. Such requests have been processed under our existing regulations. While we have been able to dispose of all requests to date satisfactorily, the wide-ranging nature of the requests highlights the need for a new set of regulations that recognizes GAO's unique status and details the types of records that may be disclosed in the light of that status.

New freedom of information regulations for GAO are being developed, and 1977 issuance is anticipated. These new regulations, when issued, will be the subject of a second, more detailed article in the *Adviser.* For the time being, it may be helpful to keep in mind these guidelines followed by OGC in applying the existing regulations:

1. GAO's policy favors the fullest possible disclosure.
2. Requests for records should be in writing. Oral requests may be considered, but it is best to ask for written confirmation. The requester should be told that although GAO is not subject to the act, we have

[1] Senior Attorney (Special Studies and Analysis), Office of the General Counsel, GAO.

[2] Pub. Law 89-487, 80 Stat. 250, codified by Pub. Law 90-23, 81 Stat. 54 (June 5, 1967), 5 U.S.C. §552 (1970).

[3] Pub. Law 93-502 (November 21, 1974).

[4] This is based upon a legal interpretation that has not been tested in the courts. B-161499 – O.M., July 3, 1967.

[5] *Ibid.*

[6] 33 F.R. 357, January 10, 1968.

similar regulations (4 C.F.R. Part 81), and we will consider the request under those regulations.

3. The following categories of records are exempt from disclosure (but the exemptions may be waived in certain circumstances);

   —congressional correspondence, including congressional contact memos,
   —documents bearing security classifications,[7]
   —records specifically exempt from disclosure (for example, commercial data covered by 18 U.S.C. §1905),
   —records containing trade secrets and commercial or financial information obtained from any person that is privileged or confidential,
   —intra-agency or interagency memoranda or letters,
   —personnel and medical files (and similar files), where disclosure would result in a clearly unwarranted invasion of personal privacy,
   —investigatory files compiled for law enforcement purposes,
   —records relating to the regulation and supervision of financial institutions, and
   —records containing geological and geophysical information and data concerning wells.[8]

4. It is generally up to the division or office having possession of the requested records to determine initially whether they should be disclosed. Key factors to keep in mind when making that decision are:
   —whether the records relate to work done at specific congressional request,
   —whether the records originated elsewhere in the Government,
   —whether disclosure would impede GAO activities or the conduct of a particular audit,
   —whether disclosure would result in an invasion of personal privacy, or violate a pledge of confidentiality,
   —whether the records contain purely factual information, or involve internal opinions and recommendations, and
   —whether, all factors considered, disclosure would be in the public interest.

Under the existing regulations and procedures, processing freedom of information type requests is the responsibility of the Office of Administrative Services. However, because of its work in developing GAO's new regulations, OGC has become intimately involved in processing such requests, particularly where they must be denied.

Should you receive a freedom of information type request, either written or oral, you should be guided generally by the provisions of GAO Operations Manual Order No. 1330.1. You should send a copy of the request to OGC, and, if you feel a need for more particular guidance (especially if the request cannot be honored or is complex), you should feel free to consult OGC for advice and assistance.

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[7] *See*, GAO Operations Manual Order No. 0930.1 for a description of this type of information.

[8] *See*, GAO Operations Manual Order No. 0940.2 for a description of this type of information.

COMMENT

NEW SAFEGUARD FOR CONFIDENTIALITY OF GAO DRAFT AUDIT REPORTS

As you may have noticed, the legend on the cover for General Accounting Office draft audit reports has recently been changed. The legend formerly read:

> "This document is a *draft* of a proposed report of the General Accounting Office. It is subject to revision and is being made available solely to those having responsibilities concerning the subjects discussed for their review and comment to the General Accounting Office.
>
> "Recipients of this draft must not show or release its contents for purposes other than official review and comment under any circumstances. At all times it must be safeguarded to prevent premature publication or similar improper disclosure of the information contained therein."

The new version states:

> "This document is a *draft* of a proposed report of the General Accounting Office. It was prepared by GAO's staff as a basis for obtaining advance review and comment by those having responsibilities concerning the subjects discussed in the draft. It has *not* been fully reviewed within GAO and is, therefore, subject to revision.
>
> "Recipients of this draft must not show or release its contents for purposes other than official review and comment under any circumstances. At all times it must be safeguarded to prevent publication or other improper disclosure of the information contained therein. This draft and all copies thereof remain the property of, and must be returned on demand to, the General Accounting Office."

The new legend incorporates several changes to make clear that draft reports are, and remain, the property of GAO. Thus, the second paragraph has been thoroughly revised. The first sentence precludes recipients from releasing the contents of draft reports "for purposes other than official review and comment under any circumstances." The second sentence amplifies this injunction against improper release.

Finally, a new sentence has been added at the end of paragraph 2 that reads:

> "This draft and all copies thereof remain the property of, and must be returned on demand to, the General Accounting Office."

Undoubtedly, many of you wonder about the reason for the change, and, more importantly, about its practical significance.

As to the former, the change resulted from a recurring problem in maintaining the confidentiality of GAO draft reports while they were in the hands of executive agencies for comment and response. It seems the Department of Justice was advising executive agencies that it perceived no legal basis upon which it could adequately defend the agency's refusal to release the draft reports to anyone who demanded them pursuant to the Freedom of Information Act.[1] GAO has long taken the position that, as a legislative branch agency, it is not subject to the act.[2] The Department of Justice informally agrees with this position.

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[1] 5 U.S.C. §552 (1970).

[2] GAO does have its own regulations governing public access to records at 4 C.F.R., Part 81. These regulations would normally not permit access to draft audit reports.

The Freedom of Information Act does contain an exception to disclosure that GAO believed would protect its draft reports while in the hands of agencies that are subject to the act. Section 552(b)(5) of title 5 of the U.S. Code exempts intra- and interagency memoranda from required disclosure. However, the Justice Department did not believe that GAO draft reports could legally fall within this exception, for the very reason that GAO is not an "agency" as defined in the Freedom of Information Act.

At a meeting with representatives of GAO's Office of the General Counsel, several of the Justice Department attorneys concluded after discussion that a viable legal argument could be made that draft reports constitute "interagency memoranda" within the exception. Notwithstanding some reservations, they believed the Department could defend an agency that refused to provide draft GAO reports to Freedom of Information Act requesters. However, the Department officials reserved the option to make that decision only as concrete cases actually arose. They also firmly believed that such a defense would be greatly strengthened by the addition of a second string to the bow—that is, the argument that the draft report is, in any event, the property of GAO rather than the executive agency having possession of it.

The Justice Department believed that this alternative defense would not be maintainable without changes to the then-existing legend on GAO draft reports to clearly specify (1) that the report continues to be the property of GAO and is merely "on loan" to the executive agency for purposes of comment and (2) that, as a concomitant to continued GAO ownership and control, the draft report is subject to return to GAO on demand.

In light of the Justice Department concern, the changes discussed above were implemented. Regarding the practical effects, while the Department has been unwilling to give specific assurances as to its position in all conceivable cases, it is expected that Justice will now advise its executive agency clients that there are adequate legal grounds to support their resisting freedom of information requests for GAO draft audit reports.

NOTES

TIMING OF WEEKEND RETURN TRAVEL

We have received a number of questions concerning the timing of the weekend return travel discussed in the last issue of the *Adviser*. Specifically, the issue is whether such return travel can be conducted during duty hours or must be undertaken thereafter.

Scheduling of travel incident to temporary (TDY) assignments for official business is a prerogative of the division or office concerned. Normally, TDY travel is expected to be done during regular duty hours. The law provides that, "to the maximum extent practicable," each agency shall schedule travel away from official duty stations during the regular workweek.[1] Thus, agencies schedule travel during working hours, except where it is not practicable to do so.

However, weekend return is recognized to be a different kind of travel—primarily for the personal benefit of the employee, *i.e.*, to allow the employee to return to his home during extended TDY. Accordingly, the Comptroller General's decision of July 20, 1976,[2] held that such trips are an exception to the statutory requirement of travel during working hours, and that they "should be performed outside the employees' regular duty hours or during periods of authorized leave."[3]

Management, of course has the discretion to make exceptions where necessary, including taking action to avoid overtime claims in cases arising under the Fair Labor Standards Act. Basically, the scheduling of return travel will have to depend on the circumstances of the particular assignment, taking into consideration the distance and time required for the travel and the costs involved. As was stated in the Comptroller General's recent decision, until regulatory guidelines are developed by the General Services Administration, "agencies should make prudent use of the weekend return authority * * * "[4]

—Robert L. Higgins

[1] 5 U.S.C. 610 (b)(2)(1970).
[2] 55 Comp. Gen. 1291 (1976); *see, The OGC Adviser*, Vol. I, No. 2 at 1 (January 1977).
[3] 55 Comp. Gen. at 1292.
[4] 55 Comp. Gen. at 1293.

COPYRIGHT LAW REVISED

Since publication of the article "Copying the Copyright" in the October 1976 issue of the *Adviser*, the copyright law—title 17 of the U.S. Code—has been revised by Public Law 94-553.[1] Section 106[2] of the new act grants to the copyright owner:

> "* * * the exclusive rights to do and to authorize any of the following:
> "(1) to reproduce the copyrighted work in copies or phonorecords;
> "(2) to prepare derivative works based upon the copyrighted work;
> "(3) to distribute copies of phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending;
> "(4) in the case of literary, musical, dramatic, and choreographic works, pantomimes, and motion pictures and other audiovisual works, to perform the copyrighted work publicly; and
> "(5) in the case of literary, musical, dramatic, and choreographic works, pantomimes, and pictorial, graphic, or sculptural works, including the individual images of a motion picture of other audiovisual work, to display the copyrighted work publicly."

Fair use of copyrighted material is now explicitly permitted by section 107 of the new statute:

> "Notwithstanding the provisions of section 106, the fair use of copyrighted work, including such use by reproduction in copies or phonorecords or by any other means specified by that section, for purposes such as criticism, comment, new reporting, teaching (including multiple copies for classroom use), scholarship, or research, is not an infringement

[1] The new copyright law does not become effective until January 1, 1978.
[2] 17 U.S.C. §106.

of copyright. In determining whether the use made of a work in any particular case is a fair use the factors to be considered shall include—

"(1) the purpose and character of the use including whether such use is of a commercial nature or is for nonprofit educational purposes;

"(2) the nature of the copyrighted work;

"(3) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and

"(4) the effect of the use upon the potential market for or value of the copyrighted work."[3]

Thus, the judicial doctrine of fair use, which limits the exclusive right of the copyright owner, has gained legislative recognition. The following explanation of the fair use provision was given in the Senate report on the recently enacted law:

"The statement of the fair use doctrine in section 107 offers some guidance to users in determining when the principles of the doctrine apply. However, the endless variety of situations and combinations of circumstances that can rise in particular cases precludes the formulation of exact rules in the statute. The bill endorses the purpose and general scope of the judicial doctrine of fair use, as outlined earlier in this report, but there is no disposition to freeze the doctrine in the statute, especially during a period of rapid technological change. Beyond a very broad statutory explanation of what fair use is and some of the criteria applicable to it, the courts must be free to adapt the doctrine to particular situations on a case-by-case basis.

"Section 107 is intended to restate the present judicial doctrine of fair use, not to change, narrow, or enlarge it in any way * * *."

Since section 107 does not change the fair use doctrine as described in the October 1976 issue of the *Adviser*, the conclusions and recommendations expressed in that article remain unaffected.

—Robert G. Crystal

CPPC CONTRACTING: BASIC GUIDELINES FOR AUDIT REVIEW

A problem occasionally encountered in the audit of cost-type Government contracts is the existence of a payment structure that has the appearance of a cost-plus-a-percentage-of-cost (CPPC) contracting arrangement. Essentially, CPPC contracting arrangements provide for reimbursement to a contractor for his actual cost plus some fixed percentage of such cost.

The use of the CPPC system of contracting has been prohibited in military procurements by the Armed Services Procurement Act[1] and in nonmilitary agency procurements by the Federal Property and Administrative Services Act.[2] This prohibition against CPPC contracting is directed at the possibility that a contractor may increase his profit by carelessly or deliberately incurring excess costs at the expense of the Government under a reimbursable contract.[3]

In this regard, since the law forbids a CPPC "system of contracting," the prohibition is not limited to situations involving the invalidity of an entire contract but also applies to portions of a contract. For example, a contractor may be reimbursed under separate portions of a single contract where the payment arrangement under only one part of the contract violates the CPPC prohibition.

The Comptroller General has consistently taken the position that CPPC contract arrangements contravene the statutory prohibition and, therefore, the Government has no obligation to make payments in accordance with terms of such arrangements.[4]

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[3] 17 U.S.C. §107.

[4] S. Rept. 94-473, 94th Cong., 1st sess. 62 (1975).

[1] 10 U.S.C. §2306(a) (1970).

[2] 41 U.S.C. §254(b) (1970).

[3] *See, Muschany* v. *United States,* 324 U.S. 49, 61-62 (1945); *National Electronics Laboratories, Inc.* v. *United States,* 180 F. Supp. 337, 148 Ct. Cl. 308 (1960).

[4] *See, e.g.,* 22 Comp. Gen. 784 (1943); 23 Comp. Gen. 410 (1943); 35 Comp. Gen. 434 (1956); 38 Comp. Gen. 38 (1958); 46 Comp. Gen. 612 (1967); 55 Comp. Gen. 554 (1975).

When reviewing specific contracts in light of the Comptroller General's position, it is necessary that audit personnel be able to identify certain features of a contract that signal the possibility of a CPPC violation. The following guidelines are generally used to determine whether certain types of contractual arrangements constitute prohibited CPPC arrangements: (1) the payment is based on a predetermined percentage rate, (2) the predetermined percentage rate is applied to the actual performance cost, (3) the contractor's entitlement is uncertain at the time of contracting, and (4) the entitlement increases commensurate with increased performance cost.[5]

Consistent with the above guidelines, the Comptroller General has stated that negotiated overhead rates based on a predetermined, fixed percentage rate of direct costs to be incurred, without regard to actual overhead costs, violate the statutory prohibition against CPPC contracting.[6] Payment for cost of materials plus fixed percentages for both overhead and profit also violates the CPPC prohibition.[7] However, the prohibition is not violated where the overhead rate is subject to retroactive revision,[8] or where the overhead allowance is subject to a ceiling.[9] However, a ceiling in a CPPC contract does not make the contract valid where, within the ceiling limitation, it is still to the contractor's advantage to build up the cost of the performance because the contractor's fee is reduced unless he reaches the ceiling.[10]

Therefore, where fixed percentage rates are applied to the actual costs of performance under a contract, and the contract does not provide for retroactive adjustment of these rates nor limit the cost that a contractor may incur, a CPPC contracting problem may exist. In these instances there is not only no incentive for a contractor to limit his costs, but in fact a positive incentive to run up such costs.

If, in the course of an audit review of particular contracts, questions arise regarding any potential CPPC arrangements, consult OGC with regard to the particular arrangement in question.

—Ernie E. Jackson

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[5] *See*, 55 Comp. Gen. 554 (1975); B-164562, February 17, 1972. *See also*, Reda, "Anatomy of Cost-Plus-Percentage-of-Cost," AF JAG L. Rev. (No. 5) 39 (1968).
[6] 35 Comp. Gen. 434 (1956).
[7] 46 Comp. Gen. 612 (1967).
[8] 35 Comp. Gen. 434 (1956).
[9] 35 Comp. Gen. 63 (1955).
[10] 38 Comp. Gen. 38 (1958).

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