UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON 25, D.C.

DEFENSE ACCOUNTING AND
AUDITING DIVISION

DEC 11 1961

B-145738

The Comptroller General:

The question has arisen as to whether the Navy has authority to permit a contractor under a facilities contract (1) to retain, for a period of five years, rentals due the Government for the use of such facilities in commercial work, and (2) to use such funds during this period for extraordinary maintenance projects approved by the Navy.

The Navy and Convair, a Division of General Dynamics Corporation, executed a facilities agreement, NOrd(F)-1492, dated May 23, 1951, which provided for the construction and equipping of a plant to be used for Government production. (Attachment 1)

By letter dated March 30, 1957, to the Chief, Bureau of Ordnance, Convair requested permission to use the Government facilities in performing some of its commercial work. Under authority granted to the Secretary of the Navy by 10 U.S.C. 2667, the parties executed amendment 30 to the contract, effective August 30, 1957, permitting such commercial use for a term of five years ending August 30, 1962.

For certain Government work, amendment 30 provides that Convair pay a use charge to the Treasurer of the United States within 30 days after the close of each calendar quarter, computed at 2.2 percent of the estimated quarterly sales dollars and 2.5 percent of any sales in excess of the estimate. For commercial work, the amendment provides for an identical computation of rent but instead of making payments to the Treasurer of the United States, as is provided for rentals for Government work, the amounts computed for commercial work are set aside in a fund to be used for extraordinary maintenance expense, subject to the approval of the Bureau of Naval Weapons. Any unexpended funds remaining at the expiration of the term, August 30, 1962, are to be covered into the Treasury. (Attachment 2)

Our review disclosed that as of August 31, 1961, a total of $141,306 in rentals for commercial use of the facilities had been accumulated in the fund, after deduction of $1,495 for extraordinary maintenance expended with Navy approval. Six other projects in the total amount of $199,227 have been proposed by Convair. Of these, one in the amount of $10,000 was approved and two in the amount of $69,227 were disapproved; the last three proposed in June 1961 in the total of amount of $120,000

are being held in abeyance by the Navy because of inquiries made by this Division concerning the propriety of this leasing arrangement.

Leases of Government property are governed by 40 U.S.C. 303(b) which states that, except as otherwise provided by law, such leasing shall be for a money consideration only and that a rental agreement shall not include any provision for the alteration, repair or improvement of such property as part of the consideration for the rental. It further provides that all rentals shall be covered into the Treasury as miscellaneous receipts. 10 U.S.C. 2667 provides for the leasing of nonexcess Government property by the Secretary of a military department whenever he considers it advantageous to the United States. 10 U.S.C. 2667(b)(5) states that, notwithstanding the provisions of 40 U.S.C. 303(b), such a lease may provide for the maintenance, protection, repair, or restoration of the leased premises as part or all of the consideration. 10 U.S.C. 2667(d) provides that money rentals received under such leases shall be covered into the Treasury as miscellaneous receipts. 31 U.S.C. 484, provides that the gross amount of all moneys received from whatever source shall be paid into the Treasury as soon as possible without any deduction for any expenses or claim of any description whatsoever. It is noted that in 35 Comp. Gen. 113, a leasing agreement in a GSA contract, almost identical with amendment 30, was held to be in violation of this statute.

On June 27, 1961, following informal discussions with a representative of the General Counsel's Office, the Defense Accounting and Auditing Division issued a letter report to the Secretary of the Navy questioning the legality of the retention by Convair of rentals due the Government to be used, if needed, for extraordinary maintenance. We took the position that an undefined and unspecified amount of extraordinary maintenance is not proper consideration for a lease under 10 U.S.C. 2667(b)(5). Further, we stated that the statute does not specify extraordinary maintenance as consideration, nor does it permit the contractor to retain all or part of the money consideration for the term of the lease. (Attachment 3)

The Assistant Secretary of the Navy (Installations and Logistics) submitted the Navy's formal position on our finding in a letter dated September 13, 1961. (Attachment 4) He stated that the question is essentially one of legal interpretation of 10 U.S.C. 2667, and he incorporated the views of the General Counsel of the Navy in his reply. The Navy contends that,

(1) according to the House Report on the bill, the maintenance and repair provision was included in the statute so that each leased plant could be placed on a self-maintaining basis, and also because it would appear to be impracticable for the Government to assume the obligation for maintenance and repair at Government expense;

(2) maintenance may be "normal" or "extraordinary," and since it may be difficult to predict what the amount of extraordinary maintenance may be over the long term of a lease, it is fair and reasonable to have the lessee's long-term maintenance obligation accrue in periodic installments;

(3) it is essential to provide for such contingency by the accumulation of funds from year to year with a cost limitation, in terms of the agreed rental, on the work the lessee will be required to do; and

(4) until the term of the lease expires, there are no "money rentals" which are required to be deposited in the Treasury.

The House Report on the bill clearly shows that it was intended to authorize maintenance and repair by the lessee as consideration for the lease, so that each leased plant could be placed on a self-maintaining basis. However, the report also states that all money rentals received directly under any such leases would be paid into the Treasury as miscellaneous receipts.

We recognize the difficulties experienced by the Navy and Convair in attempting to negotiate a lease on the basis of extraordinary maintenance as consideration for the lease. While normal maintenance and repair costs may be anticipated on the basis of past experience, extraordinary maintenance costs are generally unpredictable. It seems unlikely that, as a practical matter, either party could reasonably agree to an unidentified and unpredictable cost as consideration for a lease. Therefore, the parties agreed to set up a monetary fund to be used when, and if, extraordinary maintenance projects were required and approved. It is our opinion that under these circumstances consideration for the lease is the money rentals specified in the lease.

In this regard, while there is a difference between 40 U.S.C. 303(b) and 10 U.S.C. 2667 in what constitutes consideration for a lease of Government property, they both provide that money rentals shall be deposited in the Treasury. Further, 31 U.S.C. 484 provides for the deposit of the gross amount of all rental moneys for the use of the United States into the Treasury. However, the Navy has commented that, until the term of the lease expires, there are no money rentals received which are required to be deposited in the Treasury. In 35 Comp. Gen. 113, similar provisions in GSA leases were held to be unauthorized, and the Comptroller General stated, on page 116, that, "Action should be taken in your Administration to revise the contracts and contract forms accordingly and to deposit into the Treasury as miscellaneous receipts any amounts now held in the reserve funds."

Instructions are requested as to the action to be taken in this matter.

Harold H. Rubin
Associate Director

Attachments (4)

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B-145738-O.M.

January 18, 1962

Director, Defense Accounting and Auditing Division

Returned. As pointed out in the administrative reply, it is stated in House Report No. 623, 80th Congress, which comprises a part of the legislative history of 10 U. S. C. 2667, that the purpose of permitting the maintenance and repair of leased premises to serve as part or all of the consideration for the lease of the property was "so that each leased plant could be placed on a self-maintaining basis" and "because it would appear impracticable for the Government to assume the obligation for maintenance and repair at Government expense."

In view thereof, we see no sound basis to disagree with the administrative view that the statute permits extraordinary as well as ordinary items of maintenance, as these terms are explained in the administrative reply, to serve as part or all of the consideration for the lease.

Having reached this conclusion, question then arises as to whether the lease terms make proper provision for funding extraordinary maintenance, or whether the funds set aside therefor in the special account represent money rentals received by the Government directly under the lease required to be deposited as miscellaneous receipts. Relative to this point, the Navy explains its position as follows:

> "Since it may be difficult, if not impossible, to predict the amount of the work in the latter category /extraordinary maintenance/ which may accrue over the long term of a lease, the most practical and effective

way of defining the lessee's obligation in this regard is in terms of a cost limitation upon the work he will be required to do thereunder. In particular cases, lessees may not be willing to assume a burden of such unpredictable and imprecise scope without a cost limitation making it definite and certain. In such cases, it is fair and reasonable to make the lessee's long-term maintenance obligation accrue, like rent, in periodic installments. On the other hand, the need for major maintenance, repair and restoration to be done in discharge of the lessee's obligation may not arise for years. Accordingly, it is essential to anticipate long-term maintenance, repair and restoration projects and to provide for them by the accumulation or carry over from year to year of the balance of the lessee's obligation for such work. At the same time, to prevent a windfall to the lessee in the event the full amount of long-term work anticipated and provided for does not in fact become necessary during the term of the lease, it is plainly in the best interest of the Government to require the lessee to pay additional rent equivalent to the unexpended balance of his accrued maintenance obligation. Until the happening of this terminal contingency, which in effect substitutes a rental obligation for the maintenance obligation, there are no 'money rentals' which are required to be deposited in miscellaneous receipts."

Under the terms of the lease no money for rental is due the United States until the lease term expires. However, during the tenure of the lease the contractor can be called upon to use such funds to perform items of extraordinary maintenance within specified cost limitations. The retention of the funds by the contractor during the term of the lease for use only in connection with extraordinary maintenance projects approved by the contracting officer appears to be a reasonable exercise of the broad authority granted the military departments in prescribing the terms and conditions incident to leasing property, and not inconsistent with the legislative intent to obviate the need for appropriations for the cost of maintenance and repair of the property, which otherwise would be the case if the funds were deposited as miscellaneous receipts prior to expiration of the lease. See U. S. Code Congressional Service 80th Congress, First

Session, pages 1592, 1599. We feel, therefore, that the amounts set aside on the books of the contractor do not represent money rentals directly received under the lease but that an amount equal to the balance therein becomes so only when the lease term expires.

Accordingly, lease terms such as contained in amendment No. 30 need not be further questioned regarding the matter considered herein. However, projects approved as extraordinary maintenance items should be scrutinized to determine that such items are, in fact, projects that could otherwise be properly charged against appropriations for maintenance and repairs.

FRANK H. WEITZEL

Assistant Comptroller General
of the United States

Attachments