

DECISION

35-192
**THE COMPTROLLER GENERAL
OF THE UNITED STATES
WASHINGTON, D.C. 20548**

FILE: B-208422

DATE: July 21, 1983

MATTER OF: GSA procurement of equipment under 40 U.S.C.
§ 481(a)(3).

DIGEST:

1. Contract between General Services Administration (GSA) and a non-tariffed supplier for procurement of telephone equipment and related installation and maintenance services is one for "public utility services" within the scope of 40 U.S.C. § 481(a)(3) (authorizing GSA to make contracts for public utility services for periods up to 10 years), since it is the nature of the services provided and not the nature of the provider of the services that is determinative for the purpose of the law. Sale of telephone equipment is a utility type service. Installment purchase contracts as well as leases or leases with options to purchase are within the scope of 40 U.S.C. § 481(a)(3).
2. For the purpose of financial reporting GSA should capitalize equipment and installation portion of procurement characterized as a lease with an option to purchase (which in this case should be treated as an installment purchase contract), since it is clear that GSA intends to exercise option to take title to equipment at cost of \$1 at expiration of 5-year contract term. Also, should GSA cancel contract, title to equipment would immediately vest in GSA and payment would be handled as provided for in the contract. See 2 GAO 12.5(d).
3. GSA under authority of 40 U.S.C. § 481(a)(3) may obligate only the amount necessary to cover its annual

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purchase contract (which in this case should be treated as an installment purchase contract) against the capital investment apportionment of the Federal Telecommunications Fund.

This decision is in response to a request from Leroy P. Boucher, Director of Finance, Office of Plans, Programs and Financial Management, General Services Administration, (GSA) requesting a decision under 31 U.S.C. § 3529 as to the propriety of, and the funding treatment to be accorded to, a contract awarded to Centel Communications (Centel) to provide telephone equipment and related services to Federal offices located in the Denver, Colorado area. As we will explain in more detail below, GSA in reliance upon authority contained in 40 U.S.C. § 481(a)(3), has entered into a long term lease-purchase contract (which is in reality an installment purchase contract) for equipment and related services from Centel and is financing its contract obligations by using the Federal Telecommunications Fund (Fund) established by 40 U.S.C. § 757. GSA plans to obligate the Fund for its costs under the contract annually, rather than obligating the total estimated costs under the contract at once.

Specifically, we have been asked:

1. Whether the procurement of equipment and related services should properly be considered one for utility services within 40 U.S.C. § 481(a)(3);
2. Whether the lease-purchase agreement should be capitalized as an installment purchase for the equipment and installation portion;
3. Whether GSA should be required to obligate the total cost of equipment and installation at the time of capitalization or annually as the services are provided and paid for; and,
4. Whether the obligations incurred should be reported against the Fund's "normal operations" or its "capital investment" apportionment?

For the reason stated below, we find that the contract may be considered one for public utility services within 40 U.S.C. § 481(a)(3); the contract should be capitalized for financial reporting purposes as an installment purchase; the costs should be obligated against the Fund annually; and, the obligations should be reported against the Fund's capital investment apportionment.

Background

Solicitation No. CDPW-79-00031-7-W7 was issued on February 5, 1980, to acquire a fully automatic telephone switching system and associated installation and maintenance services to satisfy the incidental day-to-day telephone communication requirements of Federal agencies in the Denver, Colorado area.

Paragraph T-402 of the solicitation specified that the Government intended to award a contract for the initial term of 60 months plus installation lead time from date of award, and that a contract life of 120 months was contemplated through the exercise of successive renewal options after the initial term, said options not to exceed 12 months each until the 120 month contract life was completed. In no event would the total contract term exceed 10 years (120 months) from the date of award (T-404).

The solicitation is a model request for proposals (RFP) developed by GSA for use in its competitive telecommunications program. The Denver requirement is expected to be satisfied by a proposed system containing 6,000 main stations, with a forecasted growth to 13,000 main stations during the contract life.

Three proposals were received. One of the offers was from the local franchised telephone company, the other two were from non-tariffed suppliers (interconnects). Interconnects provide service through attachment of their or other companies' equipment to tariffed telephone networks. Centel, an interconnect, submitted the lowest overall cost proposal, a lease offer that included an option to purchase the equipment at the end of 5 years of system operation for \$1. Contract GS-00C-70057 was awarded to Centel on May 14, 1982, for an estimated 5-year cost of \$120,303,798.

While it is clear that the Fund is available to purchase, install, and maintain the equipment in question^{1/}, the Fund has insufficient resources to permit GSA to obligate the estimated total cost of the first 5-year term under the agreement. Consequently, unless authority may be found elsewhere for GSA to contract in advance of, or in excess of, appropriations, the agreement would be in violation of the provisions of the Antideficiency Act, 31 U.S.C. § 1341, and 41 U.S.C. § 11.2/ See for example our decision in the matter of the General Services Administration's General Supply Fund, B-199921, June 10, 1981. This would be true whether we characterized the agreement as an installment purchase contract or a lease-purchase agreement for

purposes of financial reporting.^{3/} GSA's General Counsel contends that the necessary "contract authority" i.e., authority to commit the Government in advance or in excess of appropriations, may be found in 40 U.S.C. § 481(a)(3).

Applicability of 40 U.S.C. § 481

Section 201(a)(3) of the Federal Property and Administrative Services Act of 1949, as amended, 40 U.S.C. § 481(a)(3) provides that:

"(a) The Administrator shall, in respect of executive agencies, and to the extent that he determines that so doing is advantageous to the Government in terms of economy, efficiency, or service, and with due regard to the program activities of the agencies concerned--

* * * *

"(3) procure and supply personal property and nonpersonal services for the use of executive agencies in the proper discharge of their responsibilities, and perform functions related to procurement and supply such as those mentioned above in subparagraph (1) of this subsection: Provided, That contracts for public utility services may be made for periods not exceeding ten years; * * *" Emphasis supplied.

The purpose of the proviso authorizing contracts for public utility services to be made for up to 10 years is to permit GSA to take advantage of discounts offered under long term contracts.^{4/} If this provision is applicable, GSA need not have available to it budget authority to obligate the total estimated cost of the Centel contract, but only sufficient budget authority to obligate its annual costs under the agreement.^{5/}

The contract with Centel envisions the procurement of telephone equipment as well as services. In fact, as we will discuss in more detail below, it is an installment purchase contract. Thus the question to be resolved is whether this installment purchase contract may properly be considered a contract for "public utility services" within 40 U.S.C. § 481(a)(3).^{6/}

GSA in support of its contention that procurement of telephone equipment and related services are public utility services argues that:

"When the Property Act was passed, telephone services were only available from regulated telephone companies. Services were furnished under approved tariff prices, terms and conditions. Unlike other utilities such as gas, water and electric, where the commodity provided is consumed, telephone services included the provision of various terminal (phone sets) and ancillary (switchboards) equipment. Although one needed an electrical appliance to consume electricity and the appliance is somewhat analogous to the phone, the electrical appliance was not provided by the utility whereas the phone instrument was. The dial phone was subject to regulation while gas, electric and water consuming equipment was not. If one wanted telephone service one could only get it through equipment supplied by the telephone company.

"In 1968, the Federal Communications Commission (FCC) decided that equipment available from nonregulated suppliers could be attached to or interconnected with equipment and systems furnished by regulated carriers. (Carterfone, 13 FCC 2d 480, June 27, 1968, 1CLSR 1019). This decision opened a new market for potential suppliers of telecommunications equipment. In 1974, GAO issued a far reaching decision which held that GSA was required to obtain competition to the maximum extent practicable in the procurement of public utility services. RCA Alaska Communications, Inc., * * * [B-178422, June 20, 1974].

"In response to the RCA decision GSA established a competitive procurement program for telecommunications services. A model RFP was developed containing evaluation criteria designed to place the regulated carriers and nonregulated suppliers on equal footing. The first contract awarded under this program was to an interconnect for the outright purchase of a 500 main station system for the Veterans Administration in Albuquerque, New Mexico. Approximately 60 contracts have been awarded under our competitive procurement program. Sixty percent of these contracts are with interconnect companies; 50 percent of that number were for purchase or lease with an option to purchase. * * * In the Denver procurement GSA

estimates it will save the Government 9.3 million dollars over the contract life by awarding to Centel.

"Traditionally, the tariffed companies did not offer equipment for purchase. This was a matter of policy rather than regulation. When a utility company seeks an increase in revenue before a regulatory commission, the granting of such increase is a function of the company's rate base (investment in capital assets) and the current cost of money. Regulated telephone companies have chosen to increase their potential for maximizing revenues by keeping telephone equipment in the rate base. Under the regulated telephone company's policy, GSA does, in fact, pay for the full capitalization costs of the equipment but does not acquire title. In contrast to the regulated carriers, interconnects have offered equipment for either lease or purchase. For cash flow reasons, interconnects do not want to tie up their capital. In most cases the interconnects depend heavily on bank financing.

"It has been the position of GSA that the contracts which we enter into for telephone services are public utility services contracts regardless of whether the successful offeror was a tariffed carrier or an interconnect company. GSA has viewed the equipment involved in telecommunications procurements as incidental to the service. Historically, this was a reasonable determination since: (1) a single RFP culminating in the same term of contract was necessary to evaluate the available competition; (2) the ten-year contracting authority has always been available to use with the predominant offeror (the tariffed carriers) due to the expected economic advantage to the government; (3) that which was being offered by all offerors and ultimately contracted for to meet this requirement was the same; (4) the economic advantage to the government in using the ten-year authority was of the same kind for the same reasons, regardless of who was the successful offeror; and (5) the contract was fundamentally for the delivery of a public utility services.

* * * * *

"GSA has historically regarded the equipment provided with telephone services as an incidental but necessary element of the services. Thus, we have always considered the acquisition of equipment as falling within the meaning of contracts for public utility services.* * *

"We believe our interpretation reasonable since in the provision of telephone services, there is a substantial initial capital investment in equipment. A multiyear commitment by the Government facilitates long term amortization of capital costs which in turn reduces risks and results in lower prices to the Government. Such investment in equipment is characteristic of the telecommunications industry, regardless of whether the supplier is a regulated company or interconnect.

"The service is delivered through the use of the equipment. Whether the service is provided by utility-owned equipment or Government-owned equipment does not change the nature of the service."

The 1949 Act is silent as to what is meant by the term "public utility service" and the meager legislative history on the provision does not shed any additional light on the scope of the statutory term itself. However, in describing what constitutes a public utility, one court has stated:

"* * * The trend of modern decisions is to describe rather than define a public utility as being a business or service which is engaged in regularly supplying the public with some commodity or service which is of public consequence and need, such as electricity, gas, water, transportation or telephone or telegraph service. * * *" Gulf State Utilities Co. v. State, 46 S.W. 2d 1021 (Tex. Civ. App., 1932).

Further, while public utilities are generally described as providing services, we think that the concept of utility services can include the sale of a product or equipment as well as providing services in the literal sense.7/

This Office has generally adopted a pragmatic and flexible approach in interpreting the authority conferred by 40 U.S.C. § 481(a)(3). In the matter of Evan Jones Coal Co., 45 Comp. Gen. 59 (1965), a protester contested the use of the 10-year authority delegated by GSA to the Department of Defense on the grounds that the authority was available to contract only with "regulated monopolistic public utility businesses." We held that:

"The status of the Pipeline Company as a public utility under Title 42 of the Alaska Statutes is, in our opinion, doubtful. We are of this view because the company is not subject to regulatory control and because it has not served the public generally with natural gas. But the Congress has authorized long-term contracting in the case of services having public utility aspects. In doing so the Congress did not require that these public utility services be procured only from those firms which clearly come within the strict legal definition of a public utility. Perhaps in recognition of the legal imponderables involved in the application and enforcement of State laws regulating public utilities, and in view of the diversity of opinions between various jurisdictions respecting the legal character of public utilities, the Congress in its judgment determined to categorize the service rather than the contractor. Since gas is by definition a utility, and since the contract provides for the furnishing of public utility gas services, we would not feel required to question the statutory authority for the contract." Emphasis supplied. 45 Comp. Gen. 64.

Thus it is the nature of the product or service provided and not the nature of the provider of the product or services that governs the application of 40 U.S.C. § 481(a)(3). Furthermore, the concept of what product or service constitutes a public utility service is not static^{8/} for the purpose of statutory construction, but instead is flexible and adaptive, permitting statutes to be construed in light of changes in technologies and methodologies for providing the product or service.^{9/} Finally, it is also clear that while a particular activity may be a public utility service for the purpose of one law, the same activity may not be a public utility service for the purpose of another law.^{10/}

On the basis of these fundamental premises, we think that the sale of telephone equipment or facilities with related services is a public utility type service just as much as leasing the equipment to the Government at a rental designed to recover the cost of the contractor's investment in facilities and equipment over the life of the rental agreement would be.^{11/} The only difference between the two is that in the former case the Government acquires title to the system while in the latter, title remains with the utility. Thus the nature of the service is virtually identical, and in any case, the difference is not so fundamental as to warrant its exclusion from the scope of transactions to which the authority of 40 U.S.C. § 481(a)(3) applies. Consequently, we have no objection to the Centel agreement as being in excess of GSA's authority under the statute.

Capitalization

Concerning the second question as to whether the Centel contract should be capitalized as an installment purchase contract for financial reporting purposes, we note that 2 GAO 12.5(d) dealing with accounting for assets provides in part:

"Property acquired under installment contracts

"The property should be capitalized at the time of receipt or acceptance by the Government rather than periodically as payments are made or when title passes to the Government. The amount capitalized should include the purchase price plus related costs. For example, costs incurred for site preparation, installation, and similar costs related to making the equipment ready for use, incurred separately from the installment purchase contract or separately identified for payment in the contract, should be capitalized when incurred. (See also section 13.5.)

"Property acquired under lease purchase contracts

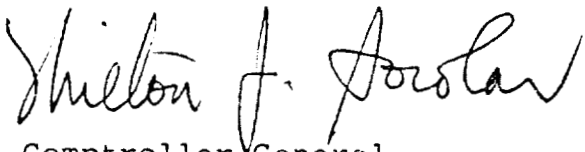
"Property acquired under lease purchase contracts should be capitalized at the time the option to purchase is exercised. The amount capitalized will normally be the purchase price stipulated in the contract less any cumulative allowances. Property acquired under lease purchase contracts which are in fact installment contracts (the decision to purchase having

already been made) will be treated for capitalization purposes as installment purchases. (See also section 13.5.)"^{12/}

We note that GSA's General Counsel has indicated that the Centel contract is considered an installment purchase contract and will be capitalized as such for financial reporting purposes notwithstanding its characterization as being a lease with an option to purchase.^{13/} Early termination of the contract vests title of the property in the Government while the acquisition cost after the full 5-year term is \$1. Thus it is a virtual certainty that GSA will exercise its right to buy the equipment at the expiration of the contract term or acquire title to the equipment prior thereto. Thus treatment of the contract as an installment purchase contract for financial reporting purposes is proper.

Obligating Costs

As we have indicated above, GSA need not obligate the total estimated cost of the contract against the Fund, but only amounts necessary to cover its annual costs under the contract. Furthermore, they should be obligated against the Fund's "Capital Investment" category B apportionment, as GSA's General Counsel has indicated. Installment of the phone system in the Denver Federal Center and specific off premises locations will improve the long term usefulness and productivity for the facilities serviced. See 2 GAO 12.5(d) & (e).^{14/}

for 
Comptroller General
of the United States

Footnotes

1/ 40 U.S.C. § 757 provides that:

"There is authorized to be established on the books of the Treasury, a Federal telecommunications fund, which shall be available without fiscal year limitation for expenses, including personal services, other costs, and the procurement by lease or purchase of equipment and operating facilities (including cryptographic devices) necessary for the operation of a Federal telecommunications system, to provide local and long distance voice, teletype, data, facsimile, and other communication services. There are authorized to be appropriated to said fund such sums as may be required which, together with the value, as determined by the Administrator, of supplies and equipment from time to time transferred to the Administrator under authority of section 486(f) of this title, less any liabilities assumed, shall constitute the capital of the fund * * *".

Thus we are not faced with the issue of funding source, as was the case in 35 Comp. Gen. 220 (1955).

2/ 31 U.S.C. § 1341 provides:

"(a)(1) An officer or employee of the United States Government or of the District of Columbia government may not--

(A) make or authorize an expenditure or obligation exceeding an amount available in an appropriation or fund for the expenditure or obligation; or

(B) involve either government in a contract or obligation for the payment of money before an appropriation is made unless authorized by law."
Emphasis supplied

41 U.S.C. § 11 provides:

"(a) No contract or purchase on behalf of the United States shall be made, unless the same is authorized by law or is under an appropriation adequate to its fulfillment, except in the Departments of the Army, Navy, and Air Force, for clothing, subsistence, forage, fuel,

quarters, transportation, or medical and hospital supplies, which however, shall not exceed the necessities of the current year.
* * *." Emphasis supplied.

- 3/ See our decision in the matter of the Navy Industrial Fund: Obligations in connection with long-term vessel charter, 62 Comp. Gen. _____, B-174839, January 28, 1983 and 48 Comp. Gen. 497 (1969).
- 4/ See Report of the Conference Committee on H.R. 4754, Rep. No. 935, 81st Cong., 1st Sess., 34 (1949) and the Report of the Senate Committee on Expenditures in the Executive Departments on S. 2020, Rep. No. 475, 81st Cong., 1st Sess., 14 (1949).
- 5/ See 35 Comp. Gen. 220 (1955) and 44 Comp. Gen. 683, 687-688 (1965). Thus there is no "full funding" requirement for long term utility contracts but instead these may be funded incrementally. Compare our decision in the matter of Newport News Shipbuilding and Dry Dock Company, 55 Comp. Gen. 812, 822-823 (1976).
- 6/ While this question concerning whether purchases of equipment are within the scope of the law has been before this Office on two other occasions, this is the first time that we will have the opportunity to decide it. See our decisions in the matter of the General Telephone Company of California, 57 Comp. Gen. 89, 96-97 (1977) and B-159559, July 29, 1966.
- 7/ See K.S.B. Technical Sales Corp. v. North Jersey District Water Supply Commission of the State of New Jersey, 376 A. 2d 960 (N.J. Super. Ct., 1977); Helvey v. Wabash County REMC, 278 N.E. 2d 608 (Ind. Ct. App., 1st Dist., 1972) and cases collected at 48 ALR 3d 1060.
- 8/ This is a reasonable interpretation of the statute since its purpose is to effect economy and improve services. By broadly construing the authority conferred, it increases the potential number of suppliers, thereby increasing competition which should result in reduced costs or increased services or both.
- 9/ See Radio Common Carriers of New York, Inc. v. New York Public Service Commission, 360 N.Y.S. 2d 552, 555-557 (S. Ct. Alb. County, 1974).
- 10/ Compare Classified Directory Subscribers Association v. Public Service Commission of the District of Columbia, 383 F. 2d 510 (D.C. Cir., 1967) with District of Columbia v. Chesapeake & Potomac Telephone Co., 383 F. 2d 510 (D.C. Cir., 1967).

11/ That the Government could pay such rental rates is equally clear. See our decision B-159559, June 19, 1967, and decisions cited therein.

12/ 2 GAO 13.5 dealing with accounting for liabilities under installment or lease-purchase contracts provides:

"The purchase price included in installment or lease-purchase contracts, which are in substance installment purchases, shall be recorded as a liability when the property is received or accepted from the contractor. For lease-purchase contracts, the purchase price shall be recorded as a liability when the option to purchase is exercised."

13/ We note that GSA's General Counsel has pointed out that the model RFP contains a number of service requirements which reinforce the application of our 10-year authority to these acquisitions. These service requirements call for the furnishing, engineering, installation, and maintenance of a complete operational in-service automatic telephone switching system. This includes switching equipment, instruments, intrasystem cabling and tie-lines, and interconnection with the local telephone system, the Federal Telecommunications System (FTS) network and commercial long-distance lines. After initial installation the contractor, whether the tariffed carrier or an interconnect, continues to be responsible for a long list of follow-on services, including:

(1) Main station installation, removal, or relocation.

(2) Extension station installation, removal or relocation.

(3) Telephone instrument (multiline, single line) installation, removal or relocation.

(4) Installation, removal or replacement of lights and other multiline instrument features.

(5) Installation of Central Office trunk terminals, tieline terminals, access lines, and all other related system switching equipment.

(6) Augmentation of switching equipment and console components as necessary for system expansion to meet growth requirements and/or to maintain G.P. specified performance.

(7) Preventive routine and remedial maintenance.

(8) Traffic and usage studies

(9) Maintenance of line record cards, house cable records, feature assignment records, system test records, trouble report records, measurement and performance data.

(10) Engineering and consulting services in support of the system when formally requested by the Government.

(11) Follow-on services for installation and removal of features and restrictions.

However, while services are clearly a part of the procurement, the contract is admittedly primarily one for the procurement of the equipment.

14/ While the distinction between capitalized expenditures and current expenses is not always clear, here the procurement of the telephone equipment qualifies as a betterment rather than merely repair and maintenance.