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

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B-132900

February 19, 1976

The Honorable George H. Mahon
Chairman, Committee on Appropriations
House of Representatives

Dear Mr. Chairman:

By letter of December 19, 1975, with enclosure, you requested our views on the legality and propriety of certain actions proposed to be taken by the Department of the Army (Army) to deal with overobligations in four separate Army procurement appropriations: Procurement of Equipment and Missiles, Army, 1971/1973; Other Procurement, Army, 1972/1974; Procurement of Weapons and Tracked Combat Vehicles, Army, 1972/1974; and Procurement of Weapons and Tracked Combat Vehicles, Army, 1973/1975. The exact amount is not yet known, but the Army estimates that the ultimate overobligations and consequent cash deficiencies will be approximately $160 to 180 million.

It appears that the overobligation results from numerous contracts--some completed and others in progress--for which recorded obligations exist in the full contract amounts. Most of these contracts have been identified. Approximately 900 contractors and suppliers are currently performing and/or awaiting payment for completed work on 1,200 contracts financed by these accounts. No payments have been made since November 11, 1975, when the Secretary of the Army directed an immediate halt to disbursement of funds from these appropriations.

Obviously these contracts violate the "Antideficiency Act," R.S. § 3679, as amended, 31 U.S.C. § 665(a) (1970), which provides in pertinent part as follows:

> "(a) No officer or employee of the United States shall make or authorize an expenditure from or create or authorize an obligation under any appropriation or fund in excess of the amount available therein; nor shall any such officer or employee involve the Government in any contract or other obligation, for the payment of money for any purpose, in advance of appropriations made for such purpose, unless such contract or obligation is authorized by law."

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See also, 41 U.S.C. § 11(a) (1970); see, e.g., 42 Comp. Gen. 272, 275 (1962). The Army is now in the process of preparing the report to the President and the Congress concerning this violation, containing "all pertinent facts together with a statement of the action taken thereon," as required by subsection (i)(2) of the Antideficiency Act, 31 U.S.C. § 665(i)(2).

In connection with consideration of the Supplemental Appropriations Act, 1976, approved December 18, 1975, Pub. L. No. 94-157, 89 Stat. 826, the Army requested statutory authority to use $165 million from its current fiscal year 1976 appropriations "for payment of unliquidated obligations heretofore incurred and chargeable to" the four prior year appropriations. A provision granting such authority, in the form of a new account captioned "Liquidation of Obligations--Army," was included in the version of the Supplemental Appropriations Act, 1976 (H.R. 10647), passed by the Senate. However, the conference committee deleted this provision from the bill, "without prejudice to those contractors having valid claims against the Government." H.R. Rep. No. 94-718, 9 (1975). The conference report stated in this regard, id. at 10, as follows:

> "The conferees are in agreement that the relief sought by the Army at this time, in the absence of the report required by law, would violate the spirit and intent of the Anti-Deficiency Act. In view of this violation, which may very well have criminal implications, and the admitted inadequate and faulty accounting and procurement management practices on the part of the Army, the conferees feel that relief should be withheld until a full review of this matter can be made by the Congress before funds are made available to restore those accounts that are in a deficiency status.
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> "At the same time, the conferees are most sympathetic to those contractors who must suffer hardships while awaiting payment of valid claims against the Army. The conferees strongly urge, therefore, that the appropriate Army finance and contracting officers expeditiously take the necessary steps to validate those outstanding claims and so notify in writing the contractors involved. This certification would serve to formally validate in writing each contractor's claim, or portion thereof, and such certification can then be used by the contractor to obtain a loan or other financial relief in order to offset any cash flow problem he might incur as a direct result of the Army's over-obligation of certain prior year procurement appropriations.

"The conferees further agreed to address this problem and to give it special attention in the second supplemental appropriation bill early next year if, in the meantime, the Army complies with the reporting procedures in accordance with the statutory requirements of the Anti-Deficiency Act."

In a letter to you dated December 19, 1975, enclosed with your letter to us, the Assistant Secretary of the Army (Financial Management) observed with respect to this problem:

"* * * Based upon information currently available, the affected contracts fall into two broad categories: those which are completed or near completion; and those under which performance is still continuing. The Army's current concern focuses on the latter group of contracts in which the contractors are continuing to perform and incur costs. Acknowledging that this difficult situation is one of the Army's own making, the Army is under some obligation to ameliorate the effects of the nonpayment on the contractors involved.

"The 'certification of claims' procedure directed in the Conference Committee report on the Supplemental Appropriation Bill is designed to provide adequate, albeit temporary, relief for those contractors who have completed or substantially completed performance. They may be able to secure private financing to tide them over until the Army is allowed to resume payment from the deficient appropriations. However, this procedure may not be adequate for those contractors who have ongoing programs. It could result in precipitating immediate suit in the Court of Claims for breach of contract. Additionally, contractors, perceiving their need to preserve their rights to damages for breach of contract and their attendant obligation to mitigate damages, may elect to stop performance under their contracts and thus adversely affect critically needed Army programs."

In view of the foregoing, the Assistant Secretary proposed several alternative courses of action with respect to uncompleted contracts as follows:

"1. Immediately terminate for convenience of the Government those contracts which are for items for which there is not a critical requirement. It is not anticipated that many contracts will fall within this category.

"2. If there is a validated requirement:

"a. Apply current funds to contracts on which payment has been stopped if current funds are available directly or through reprogramming, or;

"b. Enter into a contract modification providing for a no cost stop work order, or;

"c. Enter into a contract modification which would recognize the Government's obligation, subject to the subsequent availability of funds, to pay amounts due under the contract and, possibly, reasonable interest. Certificates of nonpayment would be furnished to contractors. In return for such commitment by Army, the contractors would be requested to agree to defer any action they might have for breach of contract. Subsequent performance under the contract would be at the risk of the contractor in that he would be assuming that legislative relief would be granted."

We have not attempted in this letter to make a detailed factual analysis of the Army's proposals listed above as they relate to the presumably numerous and varied types of procurement actions and contracts that are involved. Rather, our response is necessarily limited to a conceptual analysis of the proposals on the basis of the Assistant Secretary's letter to you and additional representations made to us in the course of informal discussions with officials of the Department of the Army. Before proceeding to discussion of the specific actions listed above, we offer several general observations which may be relevant to the Committee's consideration of this matter.

As noted, it is our understanding that the full amounts of the contracts here involved already exist as recorded obligations and thus provide the measure of the reportable Antideficiency Act violation. Since full recorded obligations already exist, the actions proposed by the Army will technically not increase the overobligation in most cases (with one exception, relating to interest, as discussed hereafter). However, the effects of the violation can be mitigated in terms of the need for deficiency appropriations to the extent that contracts have not yet been fully performed. We believe it is obvious that, once an Antideficiency Act violation has been discovered, the agency concerned must take all reasonable steps to mitigate the effects of the violation insofar as it remains executory. The Assistant Secretary's letter to you seems to recognize this principle in stating:

"The Army would be remiss if it did not point out that the foregoing course of action is proposed with respect to active contracts to minimize the possibility of a continuation of the R.S. 3679 problem. However, the Army believes the course of action outlined above conforms with the intent of the Committee direction; and further considers it to be in the Government's best interest and equitable to the contractor's performing in good faith."

Determination of what mitigation efforts are reasonable necessarily depends upon the particular circumstances involved. Ordinarily the most direct approach in the case of an overobligation by contract would be to terminate the contract for the convenience of the Government, thereby holding the actual deficiency for liquidation purposes to those costs payable to the contractor under the Termination for Convenience clause. However, there may be cases in which this approach would be inconsistent with the best interests of the Government or where more flexible alternatives exist. The Army proposals must be evaluated in this context.

Apparently the basic design of the various Army proposals is to minimize the effects of the Antideficiency Act violation while at the same time preserving the possibility that full performance may ultimately be realized under most of the contracts still in process. The latter objective is sought to be justified essentially by considerations of equity to the contractors and avoiding disruption of critically needed Army programs. While these justifications may be valid, they require some elaboration.

We do not doubt that the contractors are blameless in this matter and have legitimate legal and equitable interests. As to the justification in terms of program needs, while it may be true that the Army has "critical needs" for performance under these contracts from its own perspective, since the contracts resulted in an overobligation of appropriations, such "needs" go beyond the moneys provided by the Congress in enacting the four appropriations involved. Also, some of the Army proposals, if effected, could blur the distinction between necessary deficiency appropriations and de facto supplemental funding and could severely limit congressional options. These points are developed hereafter.

We would also point out that some of the proposals would require the acquiescence of the contractors. We have no idea whether, or to what extent, contractors will be willing or able to agree. Our analysis of the specific proposals, in the order presented by the Assistant Secretary, is set forth below.

Action 1.

Immediate termination of those contracts "for which there is not a critical requirement" will fix the Government's final obligation under each contract at the amount payable pursuant to the Termination for Convenience clause. While termination costs would be subject to liquidation by a deficiency appropriation, presumably such costs would be less than the recorded obligations now attributable to those contracts. As noted previously, the proposed termination action is the most that can be done to mitigate the consequences of the Antideficiency Act violation with respect to these contracts. There would be no legal objection to termination for convenience.

Action 2a.

The proposal to apply current funds (either directly or through reprogramming) to payments on continuing contracts is apparently designed to achieve full performance of such contracts and also provide some immediate relief to contractors by cash payments. In our opinion, this action would be precluded by 31 U.S.C. 712a (1970), which provides:

> "Except as otherwise provided by law, all balances of appropriations contained in the annual appropriation bills 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."

The purpose of this provision is to restrict the use of annual appropriations to expenditures required for the service of the particular fiscal year for which they were made. See 42 Comp. Gen. 272, 275 (1962). We have long held, consistent with the above statute, as well as 31 U.S.C. § 665(a) and 41 U.S.C. § 11, supra, that a claim against a fixed year appropriation, when otherwise proper, is chargeable to the appropriation for the fiscal year in which the liability was incurred. See, e.g. 18 Comp. Gen. 363, 365 (1938); 50 Comp. Gen. 589, 591 (1971). The same rule requires, of course, that all liabilities and expenditures attributable to contracts made under the instant three-year procurement appropriations remain chargeable to those appropriations.

As we understand the proposal, the prior year contracts under which the funds were originally obligated, would not be cancelled. Rather, only the source of funding those obligations would be changed, so that current year funds would be used to pay for performance already contracted for in previous years. Under these circumstances, 31 U.S.C. § 712a would preclude the use of current

appropriations to fund these prior year contracts since such transactions would constitute neither "the payment of expenses properly incurred" nor "the fulfillment of contracts properly made" in fiscal year 1976.

The Army presumably recognized that it had no existing authority to apply current funds to these prior year contracts in proposing that such statutory authority be provided in the Supplemental Appropriations Act, as described supra. See also the Senate report on this legislation, S. Rep. No. 94-511, 15 (1974) ("Existing law prohibits payments of obligations financed by these [prior year] accounts."). Thus action 2a, as proposed, would accomplish what the Congress specifically rejected in the Supplemental Appropriations Act.

Action 2b.

Under this proposal, the contractors would be required to temporarily discontinue performance, upon issuance of "no cost stop work orders," but the contracts would remain in effect. If funds eventually became available, performance could be completed. However, if the Congress chose not to make funds available, the contracts would presumably be terminated for the convenience of the Government at that time. While this proposal would, in effect, freeze the Government's liability at the amount already due under the contracts unless and until appropriations subsequently became available, the obvious intent is to enable the contracto to eventually complete the subject contracts and thereby enable the Army to receiv full performance.

Thus action 2b would serve to hold the Antideficiency Act violation to its present level for liquidation purposes, i.e., termination costs based on the contractor's performance up to the time of the stop work order. By the same token, the amount of deficiency appropriations necessary for these contracts would now be less than the full contract costs already recorded as obligated. Consequently, any appropriations subsequently made available at the full recorded contract amounts would in part be of a supplemental rather than deficiency nature. This situation may be illustrated by the following example:

> Assume that one of the contracts involved is a $1,000,000 contract to furnish materials, which is partially performed at the time of the stop work order. Presumably the full $1,000,000 contract price was recorded as an obligation at the time the contract was made, and will remain so since the contract is not terminated by the stop work order. However, once performance is suspended, the Government's actual obligation for purposes of a liquidating deficiency appropriation is frozen at some amount less than $1,000,000 based on Termination for Convenience costs at that stage of performance--$500,000 for illustration purposes. Thus an appropriation of $500,000 would be sufficient to liquidate the deficiency. An appropriation of the full $1,000,000 would permit resumption and completion of the contract notwithstanding the Antideficiency Act violation and over and above the legislative remedy necessary to cure the deficiency.

We perceive no legal objection to proposed action 2a since it would, in effect, maintain the status quo, thereby reserving to the Congress maximum flexibility in determining how best to deal with the situation. As noted above, Congress could decide to make only a deficiency appropriation necessary to liquidate actual obligations already incurred, and this amount would have been held to a minimum. On the other hand, should Congress decide to permit the Army to realize the full contract benefits by making an appropriation greater than the actual existing deficiency, the stop work orders could be rescinded and performance resumed. In our view, the crucial factor with respect to action 2b is that the report required to be filed by the Army pursuant to the Antideficiency Act fully apprise the Congress of the foregoing considerations and consequences, particularly the fact that appropriations in the full recorded amounts of obligations under these contracts is not necessary to cure the deficiencies.

Action 2c.

Under this proposal, contracts would be modified to recognize the Government's obligation, subject to the subsequent availability of appropriations, to pay the full contract amounts "and, possibly, reasonable interest." Although continued performance is said to be "at the risk of the contractor in that he would be assuming that legislative relief would be granted," the Army clearly contemplates that performance will in fact continue and intends to accept the benefits therefrom.

Like action 2b, the proposed contract modification under action 2c purports to freeze the Government's liability at the amount now due and payable (except to the extent that payment of interest is included, as discussed hereafter). However, unlike action 2b, we have serious doubts that the instant proposal would accomplish such a result. Even if the proposal would effectively limit the Government's liability in a strict legal sense, we believe that its implementation would seriously prejudice congressional options in dealing with the overobligation problem.

Defense Department contracting procedures under the Limitation of Cost/Funds (LOF) clause and cases in which Government liability under implied-in-fact contracts for quantum meruit has been decreed, seem relevant to the legal viability of the "contractor risk" approach proposed here. In brief, under the LOF clause, used mainly in cost-reimbursement contracts, the contractor must notify the Contracting Officer in writing when he expects to incur costs within the next 60 days in excess of a predetermined percentage of the total amount allotted

to the contract. If the Contracting Officer does not allot additional funds to the contract upon receiving such notice, the contractor is under no obligation to continue performance, and the Government is under no obligation to reimburse the contractor for costs incurred in excess of the total allotment. The clause, therefore, represents a contracting situation similar to that proposed by the Army under action 2c.

Even though the LOF clause, by its terms, makes payment for contractor performance contingent on subsequent allotment of funds, the Armed Services Board of Contract Appeals has ruled in certain cases that the contractor is entitled to reimbursement for costs incurred above the amount allotted. In Consolidated Electrodynamics Corp., 63 BCA ¶ 3806 (1963), the Board indicated that reimbursement might be proper where (1) the Government induced performance, (2) indicated to the contractor the urgency of the procurement, (3) continued to administer the subject contract, and (4) accepted the goods. The Board indicated that the LOF clause was designed to relieve the Government of additional expense while at the same time relieving a contractor of continued performance, and that the clause could not be used to obtain the contractor's performance at his own expense without just and fair compensation. Similarly, in Clevite Ordnance, Division of Clevite Corp., 62 BCA ¶ 3330 (1962) recovery was allowed based on assurances by government officials that funding would be provided when new appropriations became available, and the Government had reaped the benefits of contractor performance based on these representations. But see General Electric Co. v. United States, 412 F.2d 1215 (Ct. Cl. 1969); Acme Precision Products, Inc., 61-1 BCA ¶ 3051 (1961); Weinschel Engineering Co., 62 BCA ¶ 3348 (1962) ; Pickard & Burns Electronics, 68-2 BCA ¶ 7149 (1968), and Engelhard Industries, Inc., 68-1 BCA ¶ 6951 (1968), where reimbursement was denied in somewhat different circumstances. Moreover, in The Marquardt Corp., 66-1 BCA ¶ 5576 (1966) citing to American Machine & Foundry Co., 65-1 BCA ¶ 4654 (1965), the Board indicated at page 22,247: 168/62

> "* * * It has been held generally in this and other contexts that when the Government takes and uses contract-generated material or services it is obligated to pay for them."

Even if the contract modification here proposed is considered effective to preclude recovery under the contract, cases in which recovery has been granted on the basis of some form of quantum meruit or quantum valebant claim

for the fair value of services rendered or material provided, may be relevant. We denied such a claim in B-176498, October 2, 1973, under a contract containing a Limitation of Cost clause on the ground that in performing after the allotted amount had been reached, the contractor was acting as a "pure volunteer." However, the questions of whether the contractor was acting as a volunteer and whether a benefit had actually been bestowed upon the Government in the instant situation could only be resolved through litigation.

Analogous cases do establish the general proposition that the United States may be liable on implied-in-fact contracts. See, e.g., Security Life and Accident Insurance Co. v. United States, 357 F. 2d 145, 148 (5th Cir. 1966). A contract implied in fact is one founded upon a meeting of minds, which although not embodied in an express contract, is inferred, as a fact from the conduct of the parties showing, in the light of surrounding circumstances, their tacit understanding. See Porter v. United States, 496 F. 2d 583, 590 (Ct. Cl.), cert. denied, 95 S. Ct. 1446 (1974); Stewart Sand and Material Co. v. Southeast State Bank, 318 F. Supp. 870, 874 (D. Mo. 1970). Where the contractor acts gratuitously in incurring costs with only the mere hope that a contract may subsequently be entered into with the United States, reimbursement has been denied. See Wells v. United States, 463 F. 2d 434, 199 Ct. Cl. 324 (1972). However, where benefits are received and retained by the Government under an existing contract, recovery has been allowed. A. L. Coupe Construction Co., Inc. v. United States, 139 F. Supp. 61, 134 Ct. Cl. 392 (1956), cert. denied, 352 U.S. 834 (1956). Ordinary principles of equity and justice have been held to preclude the United States from retaining services, material, and benefits, while at the same time refusing to pay for them. See Prestex Inc. v. United States, 320 F.2d 367, 373, 162 Ct. Cl. 620 (1963). These cases indicate that recovery by the contractors might not necessarily be barred by simple inclusion in the contract of a provision indicating that any performance was at the contractor's own risk.

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The Army's proposal here seems to present a much stronger case for recovery than most of the cases cited. Under the Army's proposal, an existing contract for performance by the contractor and payment by the Government would be modified so as to provide for contractor performance, if he wished to perform, with only the possibility of Government payment. There would appear to be no reason for the modification if the Government did not want and expect performance. If performance was not expected, the existing contracts could simply be terminated for the convenience of the Government. Instead, however, payment on the contracts has been

stopped, presumably constituting breach of the contract terms, and the contractors have been requested to enter into a contract modification providing that payment is now contingent upon the future availability of funds. Moreover, the Government fully intends to accept the benefits of continued performance under the contracts, which call for the completion of various construction projects and supply contracts. This does not seem to be the type of case wherein benefit to the Government would be difficult to establish.

In essence, the Army proposes to leave existing contractsin effect, at least tacitly encourage continued performance, receive the benefits of performance, but at the same time require contractors to assume the risk of nonpayment. While judicial precedent in this regard is not absolutely clear, it does generally appear to support recovery in such circumstances. It is questionable, therefore, whether the Army's proposal would achieve the desired result of freezing the Government's liability at the amounts now due under the contracts.

Even if the Army could avoid additional legal liability in these circumstances absent necessary appropriations, implementation of this proposal would, in our view, severely restrict congressional options in considering whether such appropriations should be granted. First, it would not be clear whether deficiency appropriations in the full contract amounts are necessary to liquidate obligations since, for the reasons stated above, the Government's legal "obligation" is uncertain. More fundamentally, the Congress would be placed in the position of either accepting a fait accompli and fully appropriating for contract performance or, by refusing to fully appropriate, allowing the Army a windfall at the expense of the contractors--a result which seems inequitable at best. Moreover, even if the Congress declined to appropriate for the continued performance, the contractors might still bring suit under the contracts or on a quantum meruit theory as described above. Any judgments so obtained in the amount of $100,000 or less would then be payable from the permanent judgment appropriation pursuant to 31 U.S.C. § 724a (1970).

In view of the foregoing considerations, we believe that proposed action 2c is of dubious validity at best as a means of mitigating the effects of the Antideficiency Act violation.

Finally, there is clearly no legal basis for the inclusion of interest payments under proposed action 2c. It is well settled that payment of interest by the Government may not be made except when interest is provided for in legal and proper contracts or when allowance of interest is specifically directed by statute. See Angarica v. Bayard, 127 U.S. 251 (1888); United States v. North American Transportation and Trading Co.,

253 U.S. 330 (1920); Seaboard Air Line Railway Co. v. United States, 261 U.S. 299 (1923); Smyth v. United States, 302 U.S. 329 (1937); United States v. Hotel Co., 329 U.S. 585 (1947). Certainly, therefore, no interest can be paid on any amounts already due and payable to the instant contractors, or which will become due and payable prior to any contract modification, unless the existing contracts provide therefore. See B-103315, February 14, 1972. Moreover, any contract modification providing for interest on amounts which subsequently become due and payable, would actually increase the amount of the overobligation, above the full contract amounts already recorded as obligated. Therefore, inclusion of an interest provision would constitute a new and additional violation of the Antideficiency Act and related statutes controlling the obligation of appropriations. Cf., 51 Comp. Gen. 251, 252 (1971).

To summarize our conclusions as discussed above, action 1--termination of contracts for which no critical requirement exists--would be authorized. Action 2a--using current funds to liquidate prior year obligations--is precluded by law. Action 2b--issuance of no cost stop work orders--is authorized but its impact upon the need for deficiency funding should be disclosed to the Congress. Action 2c--obtaining continued performance on a purported "contractor risk" basis--is of dubious validity at best, and seems inferior to action 2b as a mitigation measure. Provision for interest payments under action 2c is clearly unlawful.

Sincerely yours,

Comptroller General
of the United States