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DECISION

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

FILE: B-190659 DATE: October 23, 1978

MATTER OF: Federal Data Corporation

DIGEST:

1. Where there are no disputed facts involved in claim--concerning question of law under specific GAO precedent--and claimant has not objected to GAO deciding claim, but instead has submitted argument in support of its position on merits of claim, GAO will review claim rather than returning for processing under "Disputes" clause of contract.

2. Real effect of "separate charges" provision in contract was to force contracting agency to purchase requirements from contractor for successive fiscal years or to pay damages for failure to do so. In so purporting to obligate Government, test whether charges are proper under funding laws depends on reasonableness of charges.

3. If separate charges (plus other stipulated contract payment) are unreasonable--more than lowest cost of supply or services otherwise obtainable for bona fide needs of particular fiscal year--charge cannot be considered to relate to current fiscal year need; therefore, restrictions in funding laws are violated. Under further GAO analysis, separate charges scheme is shown to violate funding laws' restrictions.

4. "Separate charges" provision was void from beginning of contract and, therefore, it is irrelevant as to which year "discontinuance" actually took place so as to give rise to separate charges claim. Because of conclusion, it is unnecessary to consider whether payment of claim would also be contrary to limits of recovery set forth in contract's "Termination for Convenience" clause.

5. Lump-sum appropriation to agency does not, in itself, ratify contract (or contract provision) otherwise in violation of funding restrictions. Although appropriate extension of improper multiyear agreement will cure multiyear defect, extension does not of itself cure unreasonable "separate charges" provision.

6. Claimant's argument that agency ratified illegal "separate charges" provision runs counter to principle that United States is not bound by unauthorized acts of its agents. Agency simply had no authority to contract for "separate charges" provision in violation of funding laws.

7. Payment of separate charges would constitute enforcement of penalty provision.

The Securities and Exchange Commission (SEC) has requested our opinion regarding its legal authority to pay claimed charges of $30,768 submitted by Federal Data Corporation (FDC) under contract SE-973 which has been terminated for the convenience of the Government.

The fixed-price contract for the rental (with option to purchase) and maintenance of a "disk drive subsystem" was awarded by the SEC to FDC on August 14, 1974, for the period from date of award through June 30, 1975.

The contract listed a table of equipment (and related maintenance) to be provided as follows:

"Basic Equipment

ITEM NO.	DESCRIPTION	QUANTITY	PURCHASE PRICE	MONTHLY RENTAL RATE	MONTHLY MAINTENANCE RATE
1	Telex 5650 Disk Controller	1	$55,100	$1,765	$441
2	Telex 5625 Disk Drive	4	[Included in price for item 1]		
3	Additional 5625 Disk Drives (up to maximum of 5 additional drives)	each	8,500	330	84

"Substitution Equipment

ITEM NO.	DESCRIPTION	QUANTITY	PURCHASE PRICE	MONTHLY RENTAL RATE	MONTHLY MAINTENANCE RATE
4	Telex 5311 Disk Controller	1	$55,100	$1,785	$441
5	Telex 5311 Disk Drive	8	[Included in price for Item 4]		
6	Additional 5312 Disk Drives (up to a maximum of 1 additional disk drive)	each	7,750	330	84"

The "CONTRACT PERIOD" clause of the contract also vested option rights for additional contract services through June 30, 1978. Exercising its rights under the option provisions, the SEC ultimately continued the rental until April 7, 1977. Separate fiscal year funds for each of the 3 years involved were used to pay FDC.

The "CONTRACT PERIOD" clause of the contract also provided:

> "* * * The Government may discontinue rental of any item of equipment upon thirty (30) days' prior written notice to the Contractor. There will be a one-time termination charge equal to six (6) total monthly payments in the event that the Government discontinues rental prior to the expiration of the thirty-six (36) month system life of equipment * * *."

The contract also contained a "Termination for Convenience" (T for C) clause which read:

> "(e) * * * the Contracting Officer shall * * * pay to the Contractor * * * [t]he costs incurred in the performance of the work terminated * * *.

"The total sum to be paid to the Contractor [incident to a T for C] shall not exceed the total contract price as reduced by the amount of payments otherwise made * * *."

From date of award until April 7, 1977* (the date on which SEC informed FDC that the contract was being terminated for convenience), the contract was amended and extended several times. Each extension of the contract under the exercised options carried forward the clauses of the contract noted above. The last extension of the contract was dated October 1, 1976.

Upon receiving SEC's termination notice, FDC submitted an invoice to SEC in late April 1977. The invoice referenced the contract provision which provided for a one-time termination charge (equal to six monthly payments) in the event of "discontinuance." The amount claimed was apparently computed by multiplying the average monthly payment (including approximately $1,000 per month of maintenance charges) received by the corporation over the life of the contract by the stated constant factor (6 months).

SEC initially replied to FDC's claim by letter of August 15, 1977. This letter denied FDC's claim to the extent the claim was based on the stated discontinuance charge. Nevertheless, SEC invited FDC to submit a proposal for settlement under the provisions of the T for C clause. FDC replied to SEC's invitation by letter of October 6 as follows:

"* * * As the only charge in dispute between the SEC and Federal Data for the termination of Contract SE-973 is the termination charge referenced in paragraph 2(b) of the Contract Specifications, [the submission of a T for C claim] would appear neither expedient nor useful. * * *"

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*Because of the 30-day notice period required, FDC was paid rentals through May 6, 1977.

SEC's August 15 letter and a subsequent SEC letter dated November 4, 1977, also informed FDC that the claim was denied because payment of the claimed termination charge (referred to hereafter as "separate charges") would violate two of our decisions--namely, Burroughs Corporation, 56 Comp. Gen. 142 (1976), 76-2 CPD 472; and Honeywell Information Systems, Inc., 56 Comp. Gen. 167 (1976), 76-2 CPD 475.

The cited decisions, in SEC's view, held that "any such separate charges upon termination are subordinate to the provisions of the Termination for Convenience clause of the contract, and that termination charges can only represent costs incurred in performance of the work terminated and certain costs directly related to the settlement of the termination claim."

Counsel for FDC takes issue with SEC's interpretation and application of our decisions in several respects. Basically, counsel argues that payment of the $30,968 of separate charges would not violate any of the funding statutes and that payment of the claim is otherwise proper.

These statutes and the interpretations that our Office and the courts have given to the statutes were set forth in the cited Burroughs decision as follows:

> "31 U.S.C. § 665(a):
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> "'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.'
>
> "31 U.S.C. § 712a:
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> "'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.' [Emphasis supplied.]

"41 U.S.C. § 11:[*]

"'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, transportion, or medical and hospital supplies, which, however, shall not exceed the necessities of the current year.'

"In 42 Comp. Gen. 272, 275 (1962), we summarized the import of these statutes as follows:

"'These statutes evidence a plain intent on the part of the Congress to prohibit executive officers, unless otherwise authorized by law, from making contracts involving the Government in obligations for expenditures or liabilities beyond those contemplated and authorized for the period of availability of and within the amount of the appropriation under which they are made; to keep all the departments of the Government, in the matter of incurring obligations for expenditures, within the limits and

*FDC argues that 41 U.S.C. § 11 applies only to military procurements. On its face the statute applies to "United States" contracts without restriction. The exception from the mandate contained in the statute applies only to the military Departments but that exception does not apply to the SEC contract in question.

> purposes of appropriations annually provided for conducting their lawful functions, and to prohibit any officer or employee of the Government from involving the Government in any contract or other obligation for the payment of money for any purpose in advance of appropriations made for such purpose; and to restrict the use of annual appropriations to expenditures required for the service of the particular fiscal year for which they are made.'

"Contracts executed and supported under authority of fiscal year appropriations, as here, can only be made within the period of their obligation availability and must concern a bona fide need arising within such fiscal availability. Leiter v. United States, 271 U.S. 204 (1926); Goodyear Tire and Rubber Company v. United States, 276 U.S. 287 (1928); 48 Comp. Gen. 497 (1969); Storage Technology Corporation, B-182289, April 25, 1975, 75-1 CPD 261. Those contracts entered into under fiscal year appropriations purporting to bind the Government beyond the fiscal year involved must be construed as binding upon the Government only to the end of the fiscal year. Leiter, supra. Specific affirmative action by the Government, in effect making a new contract and complying with the advertising requirements, is required in order to extend the term of the contract beyond the fiscal year. See 42 Comp. Gen., supra; Leiter, supra; Goodyear, supra."

The Burroughs and Honeywell decisions involved review of separate charges proposed by Honeywell Corporation. These separate charges (a penalty equal to 30 percent of Honeywell's "monthly list price" (possibly determined by reference to Honeywell's then current catalog prices) multiplied by the "discontinued" system life) were clearly intended to force the procuring agencies involved to exercise option rights rather than to pay the separate charges. Based on this circumstance and

for other reasons, we concluded that the charges did not relate to current fiscal year needs for the equipment; that the charges involved an indeterminate liability because of Honeywell's statement that the charges might be based on future catalog prices; and that the charges were, therefore, in violation of these statutes. In so concluding, we quoted with approval the following excerpt from an earlier decision (36 Comp. Gen. 683, 685 (1957)) also involving a similar separate charge:

> "'* * * Any contract provision which would obligate [the agency] to pay more than the [reasonable cost of the needed item] in any one fiscal year as a penalty or damages for failing to renew the contract for subsequent fiscal years could not be considered as pertaining to the needs of the current year. The real effect of the [separate charges] is to obligate [the agency] to purchase a certain quantity [of the item] during each of five successive years or to pay damages for its failure to do so. In other words, the [separate charges] represent a part of the price of future, as distinguished from current * * * needs under the contract, and for that reason such charges are not based on a current fiscal year need.'" (Emphasis supplied in Burroughs.)

We also observed that, if Honeywell's contract with these separate charges was "discontinued" for reasons of the Government's convenience, any payment of separate charges would be inconsistent with the standard T for C clause, because the separate charges did not "represent costs incurred in the performance of the work terminated" and might exceed the "total contract price." We noted that, in the absence of a General Services Administration waiver, an agency was not authorized to agree to termination charges inconsistent with the standard T for C clause. In any event, we stated that under an appropriate order of precedence clause the standard T for C clause would prevail over "separate charges" provisions.

FDC's Arguments

Counsel's arguments that payment of the claimed separate charges would not violate the above statutes and decisions may be summarized under the below-numbered paragraphs.

(1) The cited Honeywell decision--in which the procuring agency admitted it did not have funds to cover the potential separate charges involved--is distinguishable from the case here in which SEC did not state at any time that it did not have enough funds to cover the FDC separate charges payment.

(2) The 6-month charges do not violate 31 U.S.C. § 712a because they are being assessed in the final year of the contract. If the charges had been assessed during the first or second year, under the rationale of Burroughs, the charges would have ostensibly amounted to a "penalty or damages for failing to renew the contract for subsequent years," since the charges could not be considered as pertaining to the needs of the current year. The statute, however, does not apply to the present circumstances. Alternatively, if the separate charges were void from the beginning that character changed when Congress appropriated funds for the SEC and the SEC applied those funds to the contract.

(3) Aside from the prospective violation of 31 U.S.C. § 665(a), the cited decisions found that the proposed termination charges would not represent reasonable costs incurred in the performance of the actually performed work and hence were objectionable. Here, however, FDC has shown that the amount claimed is essentially the difference between the amount charged under the contract since 1974 and the General Services Administration's annual Automatic Data Processing (ADP) schedule prices for the same equipment during the 1974-1977 period. As the reasonable value of the services performed by FDC over the 1974-1977 period is essentially identical to the separate charges claimed, allowance of the $30,908 would not contravene the cited decisions.

SEC has not submitted any specific comments on FDC's arguments.

ANALYSIS

A threshold question is initially for review. That question is whether the referred payment question is for SEC consideration under the standard "Disputes" clause of the contract rather than for GAO review.

When a contracting agency refers to GAO a contractor's claim pertaining to matters arising under the "Disputes" clause, we have returned the claim to the agency for processing under the clause when disputed facts were involved in the claim. See Bradley Mechanical Contracting, Inc., 53 Comp. Gen. 829 (1974), 74-1 CPD 229. Here, however, there are apparently no disputed facts involved in FDC's claim and a question of law which involves specific GAO precedent is presented. Additionally, FDC has not objected to our deciding its claim, but instead has submitted argument to us in support of its position on the merits. Consequently, we will review the claim.

Application of the Funding Statutes to Separate Charges

The real effect of the "separate charges" provision in the SEC contract was the same as that resulting in the above Honeywell and Burroughs cases, namely: forcing the contracting agency to purchase its requirements from the contractor for successive fiscal years or to pay damages for its failure to do so. In so purporting to obligate the Government, the test whether the charges are proper under the funding statutes depends on the reasonableness of the charges. If the charges (plus other stipulated contract payment) are unreasonable--more than the lowest cost of the supply or service otherwise obtainable for bona fide needs of the particular fiscal year--they cannot be considered to relate to a current fiscal year need. Under this precedent, therefore, contracting for possible payment of unreasonable separate charges would offend: (a) the restriction in 31 U.S.C. § 665(a) against contracting "in advance of appropriations made for such purpose" by purporting to obligate funds for payment of a need of a subsequent fiscal year; (b)

the provision in 31 U.S.C. § 712a requiring appropriations to be applied to expenses of the particular fiscal year in question; and (c) the restriction in 31 U.S.C. § 11 requiring any contract obligation to be supported by an "adequate" appropriation--to the extent unreasonable separate charges purport to obligate a future appropriation not yet made.

The unreasonableness of the separate charges here may be demonstrated in either of two ways. The contract price for the 7 months of required services (hardware and maintenance) from October 1, 1976, to May 6, 1977, in fiscal year 1977 was approximately $35,000 (the average monthly rental of $5,000 multiplied by 7 months). If the contract had been continued for the remaining 5 months of the fiscal year, an additional $25,000 would have been expended, or a total of $60,000 for the entire third year. Under FDC's claim, the company is expecting a total of about $66,000 in separate charges and payments already made for only 7 months' service--a claimed amount which is clearly unreasonable in our view. Secondly, in order to prove that its claim of about $31,000 in separate charges is reasonable the company demonstrates its reasonableness by showing--on a submitted chart--that the charges merely represent the difference between the monthly contract price and prices existing for identical equipment on comparable General Services Administration schedule contracts. In order to demonstrate that the claimed amount is reasonable, however, FDC's chart extends from the first month of the first-year contract (fiscal year 1975) and proceeds to the eighth month of the third year contract (fiscal year 1977). But this approach fails to prove the reasonableness of the separate charges insofar as the cost of any particular fiscal year's service is concerned. On the contrary, the analysis implicitly concedes, in our view, that the separate charges payment scheme here is unreasonable as to the cost of the needs of any particular fiscal year.

Although our analysis of the unreasonableness of the amount claimed focuses on the year of termination, it makes no difference to us whether termination actually occurred in any of the other fiscal years. Because of the wording of the clause, it is clear that SEC was

purportedly obligated to pay for more than the reasonable value of the service actually furnished no matter in what month termination occurred. The conclusion is also supported by FDC's admission that if termination under the clause had taken place at any time in fiscal years 1975 and 1976, the separate charges, under the rationale of our cited decisions, would have ostensibly amounted to a "penalty or damages for failing to renew the contract for subsequent fiscal years since the charges could not be considered as pertaining to the needs of the current year."

As to FDC's argument that, because the termination did not actually take place until the last year of the contract, the separate charges would not offend the funding statutes, it is our view that the charges were void from the beginning under the funding statutes and, therefore, it is irrelevant that the "discontinuance" actually occurred in fiscal year 1977. Because of this conclusion, it is unnecessary for us to consider whether payment of the claim would also be contrary to the limits of recovery set forth in the "T for C" clause of this specific contract.

FDC's argument that, when Congress appropriated general funds to SEC for its necessary expenses, it implicitly ratified the obligation to pay $30,000 for each of the fiscal years involved also fails. A lump-sum appropriation to an agency does not, in itself, ratify a contract (or contract provision) otherwise in violation of the funding restrictions. Cf. Leiter, supra. Although an appropriate extension of an improper multi-year agreement will cure the multiyear defect itself as in Leiter, supra, the extension does not of itself cure an unreasonable "separate charges" provision. This is so because, by definition, an unreasonable "separate charges" provision concerns charges for needs other than those of the particular fiscal year involved in the extension. Moreover, FDC's further argument that SEC "ratified" the "separate charges" provision runs counter to the principle that the United States is not bound by the unauthorized acts of its agents. Alabama Rural Fire Insurance Company v. United States, No. 332-76, slip op. at page 15 (Ct. Cl. February 22, 1978), and cases cited in text.

The SEC simply had no authority to contract for a "separate charges" provision in violation of the funding statutes.

Even apart from our analysis of the violation of the funding statutes that would occur should payment of the claim be made, it is also our view that the separate charges constitute a penalty and, therefore, are unenforceable. It is well established that the intention of the parties at the time the contract is executed is determinative of whether a clause is or is not a penalty. Gaines v. Jones, 486 F.2d 39 (8th Cir. 1973). Contrary to FDC's position, the time of executing of the contract here under the Leiter decision, supra, was October 1976. To consider the contract execution date to be August 1974 would be to recognize an illegal multiyear award. As stated in Leiter:

> "* * * A lease to the Government for a term of years, when entered into under an appropriation available for but one fiscal year, is binding on the Government only for that year. McCollum v. United States, 17 Ct. Cls. 92, 104; Smoot v. United States, 38 Ct. Cls. 418, 427. And it is plain that, to make it binding for any subsequent year, it is necessary, not only that an appropriation be made available for the payment of the rent, but that the Government, by its duly authorized officers, affirmatively continue the lease for such subsequent year; thereby, in effect, by the adoption of the original lease, making a new lease under the authority of such appropriation for the subsequent year.* * *"

The "new lease" involved in the termination here was dated October 1976.

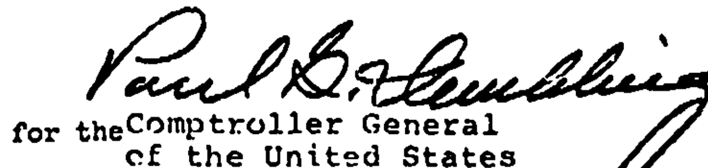
Under the authority cited in Gaines v. Jones, supra, the test to be applied in deciding the validity of an alleged penalty is:

"When the damages are uncertain in nature or amount or are difficult of ascertainment and the amount agreed on is not extravagant * * * the contract provision is upheld." (Gaines v. Jones at page 45.)

SEC argues that the charge here is a penalty since the "equipment was readily releaseable at the time of the contract's inception." Because the equipment was readily releaseable, in SEC's view, there would be no uncertainty as to prospective damages attending a termination if in fact any damages would occur. FDC would simply remove the equipment from the SEC and relet the equipment to another user--presumably at a higher price than the discounted price involved here.

FDC takes issue with SEC's position only if the position is applied to the facts as of August 1974. By this argument we assume that FDC implicitly concedes that its equipment was releaseable in October 1976, the date of the new lease in question. Because the equipment was readily releaseable in October 1976, we conclude that damages as of that date were not uncertain and the 6-month charge for termination erroneously agreed to by SEC was clearly unreasonable. Therefore, payment is also to be rejected here on the grounds that enforcement of a penalty would be involved.

Consequently, we are of the opinion that no authority exists to pay the amount claimed.



for the Comptroller General
of the United States