

GOVERNMENT CONTRACT CONTINGENT LIABILITIES,
THE ANTI-DEFICIENCY ACT,
AND
THE HOBGOBLIN OF LITTLE MINDS

By

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PREFACE

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A foolish consistency is the hobgoblin of little minds
-Emerson

I

INTRODUCTION

To deal adequately with the problems relating to contingent liabilities in Government contracting one would need to call upon the expertise of at least five different professionals. In no special order they are the lawyer, the accountant, the politician, the businessman, and the actuary. The reader should take warning that the author's credentials allow him to claim competence in only one of these areas. Recognizing his limitations, even when it comes to the legal questions that surround contingencies in Government contracting, he is, nevertheless, bold enough to approach the subject from the point of view of law, and candid enough to recognize that he will leave the reader with more questions and uncertainty than answers. He calls upon the experts from the fields of law, accounting, politics, business, and insurance, relating what they have to say, as he understands it, and asks them questions which they may answer or debate in the future. With this disclaimer and approach in mind, let us begin.

A contingent liability is one "which is not now fixed and absolute, but which will become so in case of the occurrence of some future and

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I

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A contingent liability is one "which is not now fixed and absolute, but which will become so in case of the occurrence of some future and

uncertain event."¹ The liability "is related to a transaction or event and may or may not become an actual liability depending on a future event. The uncertainty as to whether there will be a legal liability differentiates a contingent from an actual liability."² In the event the contingency in question should transpire, the liability would become actual.

Insurance may be the most common contractual relationship involving contingent liabilities. If one's person or property is injured or damaged, the insurance company will pay. The insurer's obligation to pay becomes absolute if injury, loss, or damage should occur. Warranties are another area familiar to the consumer. The manufacturer or seller of a product who warrants the product has a contingent obligation to repair or replace it in the event it should fail according to the terms of the warranty. If the product performs as warranted, the contingent liability never becomes absolute, and the manufacturer or seller never has to bear the cost of repair or replacement. Indemnity and the pendency of a lawsuit are also common examples of contingent liabilities. If the verdict goes against the defendant, his contingent liability to pay damages becomes real. And, if a third party has agreed to indemnify the defendant and hold him harmless in the event of an unfavorable verdict, the third party's contingent liability has likewise become absolute.

The contractual recognition of contingencies by identifying them and defining which party to the contract must bear the loss in the event the contingency occurs is a common means of risk allocation in contracts.

Since risk allocation is one of the major functions of a contract, contracting parties include many provisions in the contract expressly allocating both general and specific risks to one party or the other party. This is especially true with Government contracts which utilize numerous risk allocation techniques.³

Exemplary of the sorts of contingencies contemplated are those having to do with risk of loss of Government property. As a general rule, the Government is a self insurer for its own property.⁴ However, in the possession of a contractor the rules may be different. Such clauses as the Government Property clause⁵ and the Ground and Flight Risk clause⁶ set forth under what circumstances either the contractor or the Government is to assume the risk in the event of the contingency of loss of or damage to Government property in the contractor's possession.

Of course, there is no legal objection to the Government assuming the risk of loss of its own property.⁷ Nor is it illegal for contractors to assume any given risks regarding Government property in their possession. Contractors may insure against the contingencies at risk on a fixed price⁸ or cost reimbursement⁹ contract.

What makes contingent liabilities an issue and a problem in Government contracting is any situation in which the Government assumes risks which could result in its having to expend money to pay the cost of those contingencies. As early as 1909 the Secretary of the Treasury stated:

[N]o officer of the Government has a right to make a contract on its behalf involving the payment of an indefinite and uncertain sum that may exceed the appropriation, and which is not capable of definite ascertainment by the terms of the contract, but is wholly dependent upon the happening of some contingency

the consequence¹⁰ of which can not [sic] be defined by the contract.

The Secretary reached that position as the logical conclusion of the Anti-Deficiency Act, the relevant part of which is now codified at 31 U.S.C. § 1341(a). It is a position which the General Accounting Office (GAO) has furthered since that time, most notably in the area of indemnity which is discussed below. It means that the Government may not obligate itself for any liability which is indefinite in amount and uncertain of occurrence. At least that is the position GAO has taken over the years and in which the executive department has in theory acquiesced.

However, while GAO, the courts, and agencies have "consistently" stated that rule over time, they have not consistently applied the rule. Congress itself on at least three occasions has chosen not to adhere to the rule applying to contingent liabilities.¹¹ All of this has led to much confusion whenever the business and practical realities of contracting situations force the agencies to consider how to deal contractually with the contingency at hand.

While the number of contingencies which the contracting parties may consider may be legion, the most common and the most notable include the issues of 1) risk of loss of or damage to contractor property and third party claims against the contractor, 2) risk of escalation in contractor costs of performance due to economic factors beyond his control (labor and material costs), and 3) contractor rights to equitable adjustments due to constructive changes or differing site conditions. There are two other areas which do not involve risks

associated with the performance of the contract as such, but which do present the Government with contingent liabilities. They are:

1) liability accruing to the Government in the event of contract termination for convenience, especially in "multi-year" contracting, and 2) incentive contracting, a method of contracting in which the Government's maximum liability is contingent upon the contractor's total cost of performance.

This paper first presents relevant legal background into the Anti-Deficiency Act and the authority of the Government to assume contingent obligations. It proceeds to discern certain rules whereby in light of the Anti-Deficiency Act, the Government may, nevertheless, legally obligate itself for contingent liabilities. It then considers the application of these rules to various situations involving contingent obligations which the Government has had to face as a practical matter over the years.

The present paper, along with other articles whose topics were dependent upon the workings of the Anti-Deficiency Act, concludes that

[t]he Anti-Deficiency Act is significant legislation that is not well understood or applied. Too little guidance, too little interpretation and too little assistance in applying the statute are available from the [departmental level] or the [agency] in the field at all levels, but particularly at the installation [i.e., contracting officer] level. Guidance is erratic and at times inconsistent. (Emphasis added.)¹²

It is an area where consistency is much talked about and touted, but little practiced. This situation makes it especially difficult for lawyers and other little minded people to grapple with the subject.

Before considering the application of the Act and the rule it

engendered to certain contingencies, however, it will be necessary to review the rudiments of the Anti-Deficiency Act and how it has been understood and dealt with by the agencies.

II

THE ANTI-DEFICIENCY ACT

For which of you, desiring to build a tower, does not first sit down and count the cost, whether he has enough to complete it? Otherwise, when he has laid a foundation, and is not able to finish, all who see it begin to mock him, saying, "This man began to build, and was not able to finish." Or what king, going to encounter another king in war, will not sit down first and take counsel whether he is able with ten thousand to meet him who comes against him with twenty thousand? And if not, while the other is yet a great way off, he sends an embassy and asks terms of peace.

-A parable of Jesus

recorded in St. Luke's Gospel 14:28-32

A.

OVERVIEW OF THE ACT

On its face the Anti-Deficiency Act does not appear to be at all complicated. It simply says that the Federal Government may not spend money it does not have. An Air Force Pamphlet distributed for popular use within the financial management area says, "Very basically, [an Anti-Deficiency Act violation] is when someone obligates the Federal Government to spend money, or actually spends money, for which funds are not authorized or available."¹ Contracting Officers can't spend what they don't have, nor can they obligate the Government to spend what has not been entrusted to them to spend.

The crux of the statute is codified at 31 U.S.C. § 1341(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.

1. History of the Act.

The statute and precursors of it extending back in time at least as early as 1820 have been legislative attempts by Congress to maintain its constitutional prerogatives regarding public monies. The "power of the purse" is entrusted to Congress by § 8, Article I of the Constitution.² Further, Article I § 9, clause 7 provides, "No Money shall be drawn from the Treasury but in Consequence of Appropriations made by Law..."³

The Act has existed in various forms since 1870. In that year Congress enacted the present Act's predecessor providing:

That it shall not be lawful for any department of the government to expend in any one fiscal year any sum in excess of appropriations made by Congress for that fiscal year, or to involve the government in any contract for the future payment of money in excess of such appropriations.⁴

The statute was revised in 1905 and 1906, and again in 1950. Those revisions have been aptly summarized as follows:

In 1905 Congress had amended the [Anti-Deficiency Act] to give it teeth. All "obligations," rather than just contracts, were prohibited unless adequate appropriations were available. Acceptance of voluntary services was forbidden, apportionment by monthly allotments was required (unless waived), and criminal penalties were included for violation of the act.

Even after the amendments, the year 1905 brought almost as many deficiencies as the preceding years. Hence, Congress once again returned to the legislative drawing board. In 1906 the [Anti-Deficiency Act] was amended to prohibit waiver of apportionment except in emergencies or unusual circumstances. Waivers and modifications of apportionments were required to be in writing and the reasons to be given in "each case."

After 1906, [the Anti-Deficiency Act] remained

unchanged until 1950. In that year the statute was revised to create an elaborate scheme for apportionment and reapportionment. Criminal penalties for knowing and willful violations were set at a fine of not more than \$5000, imprisonment for not more than 2 years, or both. Administrative discipline was provided for noncriminal violations. [The Anti-Deficiency Act], as revised in 1950, ⁵ is essentially the controlling statute today.

2. Reasons for the Act.

"You can't spend what you don't have" is a commonplace which hardly seems as if it would need to be legislated. However, history reveals that the law was enacted on account of gross abuses of fiscal responsibility.

It is no secret that for many years after the Constitution was adopted, executive departments and agencies paid little attention to congressional spending limitations. Obligations were made in excess of or in advance of appropriations. Funds were commingled or used for purposes far different than the purposes for which they were appropriated. And most egregious of all, the departments and agencies would spend their entire fiscal year appropriations during the first few months of the year and then present the Congress with a list of "coercive deficiencies." These were obligations to others who had fulfilled their part of the bargain with the United States and who now had a moral--and possibly also a legal--right to be paid. The Congress felt it had no choice but to fulfill these commitments, but the frequency of deficiency appropriations played havoc with the United States Budget.⁶

These abuses have been found back to the very beginnings of constitutional government.⁷ Wilmerding has traced the first legislative attempt to control these practices back to 1820.⁸

[S]tatutory devices designed to tighten fiscal controls were employed by Congress over the years until the advent of the War Between the States. That conflict caused Congress to remove fiscal restraints to insure support for the war effort.

All of the old executive abuses reasserted themselves during the war years. Funds were commingled. Obligations were made without appropriations. Unexpended balances from prior years were used to augment current appropriations. The cessation of hostilities did not result in a concomitant cessation of abuses. If anything, the executive departments redoubled their efforts to override the right of Congress to "control of the public purse."⁹

The first post-Civil War legislation designed to deal with these problems was passed in 1868.¹⁰ As above stated, the predecessor of the present 31 U.S.C. § 1341 was enacted in 1870.¹¹ The history of the issue since that time has been the story of growing executive sophistication in avoiding the spirit of the Act. Consequently, growing congressional reaction has checked the abuses over time until the statute evolved into substantially its present form in 1950.¹²

3. The Operation and Effectiveness of the Act.

However, with over a century of experience with the Act, the agencies have not adapted to it such as to operate within its constraints:

A 1955 study by House Appropriations demonstrated that the Antideficiency Act was far from self-executing. The most serious violations were committed by the Defense Department, partly because it had been slow in issuing directives but also because it displayed an unwillingness to comply with the statute. The study singled out other reasons for violations by the Defense Departments and the civilian agencies. An excessive number of allotments were issued in too small amounts, at too low a level in the departments, to permit accountability. Also, there were inadequate records of obligations incurred, a failure to give adequate weight to seasonal variations when making apportionments, and negligence in following established procedures.

The Pentagon's regulations to control deficiencies were issued in 1952 and revised in 1955 and 1958. Still the Defense Department continued to outdo all other agencies in the frequency and dollar amounts of

deficiencies. From 1963 through 1973, executive agencies committed 278 violations of the Anti-Deficiency Act, totalling \$188 million. The Pentagon committed 216 of those violations, representing a dollar value of \$165 million. In addition to reported violations, the General Accounting Office often advises Congress of antideficiency violations that were never reported by the agencies.

The granddaddy of all violations was a \$110 million deficiency by the Navy. By letter of April 12, 1972, Defense Secretary Laird informed Congress that the Navy had overobligated and overspent in the "Military Personnel, Navy" account.¹³

Between fiscal year 1970 and fiscal year 1978 the Army investigated 197 alleged violations.¹⁴ And the Air Force Pamphlet above referenced admits that "[t]he Air Force has in the past incurred numerous [Anti-Deficiency Act] violations. They have ranged from small amounts of less than 10 dollars to those for millions of dollars. Actually, most of the violations are on the lower side of the scale and are less than \$10,000..."¹⁵

B.

PERCEIVED REASONS FOR THE INEFFECTIVENESS OF THE ACT

1. Continuing Violations Tolerated.

Thus, the problem of Anti-Deficiency Act violations continues to the present time. There have been two large and notorious violations of fairly recent occurrence. These two have involved the Army and the Navy. Commentators on them have suggested that simultaneous with the maneuvering around the Anti-Deficiency Act, there appears a studied unconcern for and growing boldness in its violation. That this should be observed in the executive department may be due in part to a lack of consistent concern on the part of Congress and its watchdog, the GAO:

The problem stems from lack of enforcement by all three branches of government and a tacit concession by Congress that it is unable to comprehend, manage and control the financial operations of the United States. The General Accounting Office (GAO), which conceptually should provide the policing talent to Congress, has not functioned effectively in this area.¹⁶

The first of these two recent violations occurred in 1975. Involved were approximately 900 contractors and suppliers to the Army and some 1200 Army contracts.¹⁷ William J. Spriggs reported on the incident and opined thusly in a 1976 article:

Near the end of calendar year 1975, the U.S. Army reported that procurement appropriations for some prior fiscal years were in a deficit position and immediately halted payments to approximately 900 contractors and suppliers. The over-obligation resulted from numerous contracts, some completed and others in progress, for which recorded obligations existed in the full contract amounts....[the Army proposed] alternative actions with respect to the contracts involved [and the GAO] rendered [its] opinion with regard to the Army's proposed actions. Unfortunately, the Comptroller General's opinion failed to address the basic legal questions raised by the Army's violation of the Anti-Deficiency Act. The opinion ignored the applicable law concerning the status of the contracts involved and provided little guidance to Congress. Worse yet, it failed to provide guidance for remedial action in light of the status of the contracts involved.

The Comptroller General's decision ignored the series of judicial precedents which make it clear that at the time the Secretary of the Army directed an immediate halt to disbursement of funds, the contracts involved were rendered void....Many legal scholars conclude the contracts were rendered void when the Army stopped making payments.¹⁸

What is important is not only that Spriggs and the legal scholars to whom he refers may be right. But, it is also important, given the fact of a violation (as GAO found), that the consequences thereof should be a matter of debate at all. This is all the more true

considering that Spriggs argues persuasively that the alternatives proposed by the Army and considered by GAO, in the face of the violation, were themselves violations of the Act.¹⁹

Secondly, Fenster and Voltz chronicle violations alleged to have occurred in Navy shipbuilding programs:

[T]he Navy shipbuilding program has been a principal and frequent culprit in violations of the Antideficiency Act. Thus...the Navy incurred obligations totaling several billion dollars against a legally available fund total of only \$200 million. This problem, which grew up over a period of approximately ten years (1968 through 1978), eventually resulted in considerable litigation. Most of the large dollar ticket items were settled in calendar year 1978 by the Navy with the contractors involved assuming gigantic losses....[T]he litigation...forced the Navy and the Justice Department to commit themselves to interpretations of the Navy's conduct in its financial affairs in the context of the Antideficiency Act. To characterize these interpretations as erroneous hardly suggests the lack of understanding by the executive branch. A more apt characterization might be to describe the²⁰ interpretations as primitive, syllogistic and naive.

Thus, we see evidenced not only a continuing occurrence, even practice, of Anti-Deficiency Act violations, but a perception that there is within all three branches of Government unwillingness, inability, indifference, or some combination of the three when it comes to living with the Anti-Deficiency Act and dealing with violations of it. This perception is not limited to writers outside the Federal Government. It was Hopkins and Nutt, two Army judge advocates, that criticized Government dealing with the Act calling higher level guidance "erratic" and "inconsistent."²¹

2. Lack of Enforcement through the Act's Penal Sections.

Further evidence of the correctness of these perceptions that the

Government is not really seriously concerned about Anti-Deficiency Act violations is that there has never been recorded any prosecution for its violation.²² This is in face of the multitude of violations investigated and admitted over the years, and the fact that the present criminal sanctions were added in the 1950 revisions to the Act, over thirty years ago.

3. Conclusions.

It is not the purpose of this paper to conduct a trial of the accusations made by any of the above writers, or to investigate the causes of the violations, why they have not been more severely dealt with, or why anyone permits violations to continue. It is important for this paper, however, to have set forth 1) the facts of continuing violations, 2) that there has been little to no enforcement (through the penal sections), and 3) the various critical opinions quoted above. Together they provide a picture of the context in which policy is being set, law is developing, and other decisions affected by and affecting the Act are being made. It is necessary for the reader to investigate and decide for himself what all this may mean in terms of any given decision to be made. The reader must be cautious regarding the extent to which such rules as may be discerned are reliable, would serve as the basis for any given decision, or would be enforced in face of a violation of the Act.

C.

RELEVANT FEATURES AND APPLICATIONS OF THE ACT

It is further not the purpose of this paper to analyze the Act in its details. Several writers have provided excellent summaries of the

Act.²³ For comprehensive analysis of the Anti-Deficiency Act, the reader may refer to any and all of the above noted sources. However, certain proscriptions of the Act need to be reiterated for purposes of this paper.

1. Advance/Excess Obligations As Well As Expenditures Prohibited.

First of all, it needs to be emphasized that the Act prohibits not only the expenditure of money in excess or in advance of appropriations, but also the making of the obligation to expend money.²⁴ The violation is committed when the obligation is made, not just when money is paid out. Government regulations acknowledge this,²⁵ and it is the direction given to the agencies in the field.²⁶ However, it is not clear that the Government has consistently acted this way in practice. For example, Fenster and Voltz cite instance after instance of situations in which either explicitly or implicitly the Government's position has been that only failure to pay, not the obligation itself is the violation of the act.²⁷ This attitude of the Government has been traced back as far as 1879. At that time, in the face of having to seek a deficiency appropriation from an irate Congress, the Postmaster General took the position that:

[T]he post-office officials had not yet spent money in excess of their appropriations, nor would they do so; if Congress failed to appropriate the \$1,700,000 needed to fulfill their contracts, they would annul those contracts, pay the contractors one month's pay as usual in cases of reduction or termination of contract, and stop the mails; the country might be inconvenienced, but [the Act] would be inviolable. (Emphasis added.)²⁸

In commenting on the position, Fenster and Voltz observe, "The Postmaster General's remark that "'the country might be inconvenienced, but the Act would be inviolate' illustrates the executive's complete failure to recognize that the Act was violated the moment the contracts were signed and thus the obligations created."²⁹

That this position persists can be evidenced from another example from Fenster and Voltz. In the context of their argument against a Government argument that agencies "can 'cover' deficiencies by 'reprogramming' funds from other accounts within the same appropriation, or by transferring funds from a different appropriation"³⁰ they assert:

[I]n [a recent case, the contractor] claimed that the...contract in question violated the Antideficiency Act because the applicable appropriation account was overobligated by many millions of dollars. The Navy responded...that the appropriation account was "not really overobligated" because various appropriations acts had provided funds for the Navy which, since the funds were not specifically targeted to other purposes, "could have been applied in whole or in part to obligations incurred under the...contract." Note that the Navy did not even bother to assert that the funds had been administratively allocated to that purpose--in fact...no such allocation was made. As far as the Navy was concerned, it was sufficient that it "could have been" done; indeed, this was better than actually doing it, because the same money "could have" been allocated to cover dozens of other overobligations as well. This way, a small but ubiquitous reserve fund can simultaneously "cover" dozens of overobligations which collectively aggregate to far more money than is present in the fund. If this were an accurate statement of the law, the prohibition in the Act against authorizing an obligation in excess³¹ of appropriations would be completely meaningless...

A similar understanding that reprogramming can cover Anti-Deficiency Act violations may be observed in 42 Comp. Gen. 708 (1963). There, the Federal Aviation Administration (FAA) petitioned GAO regarding the use of a provision which would place the risk of loss or damage to certain leased aircraft on the Government. FAA sought to justify use of the provision to GAO. In support of its position, FAA argued "that the requirements of the Anti-Deficiency Act... are met because the "no-year" Facilities and Equipment appropriations of the FAA will remain available, with reprogramming if necessary, to meet any potential liability arising during a given fiscal year." (Emphasis added.)³²

GAO approved of the use of the clause. Thus, both the FAA and GAO approached the situation as if whether or not a violation of the Anti-Deficiency Act would occur depended upon whether or not sufficient funds would be obligated to the contingent liability in the event of its occurrence, not upon whether or not sufficient funds had been identified for the potential liability at the time the contract was executed. GAO, in effect, "overruled" itself in this regard in 54 Comp. Gen. 824 (1975), by requiring that a contingency reserve be set up at the time the contract is entered into.³³ Nevertheless, this evidences even on the part of GAO a lack of consistent appreciation for the Act's proscriptions against obligations (themselves) in excess of appropriations.

2. Advance/Excess Obligations of Administrative Apportionments Prohibited.

It is important to keep in mind that the Act is violated not only when an entire appropriation account is overobligated or spent, but also when any administrative apportionment of it is overobligated or spent.³⁴ Requirements for apportionments are as stated at 31 U.S.C. § 1512.

The present requirements regarding apportionments came into being with the 1950 amendments to the Act. Those amendments added the concept of "available appropriations." This was done in the context of setting up the requirements for apportionments and the administrative control of them. That was accomplished by adding subsections (c) through (g) of the Act, now 31 U.S.C. §§ 1341, 1342, and 1511-1516. "The 1950 revision was part of the overall effort to amplify and enforce the restrictions of subsection (a)."³⁵ Prior to those amendments the statute simply provided:

No executive department or other Government establishment of the United States shall expend, in any one fiscal year, any sum in excess of appropriations made by Congress for that fiscal year, or involve the Government in any contract or other obligation for the future payment of money in excess of such appropriations unless such contract or obligation is authorized by law...³⁶

Only the entire appropriation for the entire fiscal year was involved. Regarding apportionments the Act provided only that "[a]ll appropriations...shall...be so apportioned by monthly or other allotments as to prevent expenditures in one portion of the year which may necessitate deficiency or additional appropriations to complete the

service of the fiscal year.³⁷

Thus, there was a requirement for apportionments, but the prohibition on obligation or expenditure only went to the entire appropriation. There was no censure for or policing of the apportionment section of the Act.

However, subsections (c) through (g) of the Act as revised in 1950 mandated the establishment of a strict regime of apportionments both vertically and across time. Section (a) changed its wording from "appropriations" to "amount available [in an appropriation]." And, subsection (h) of the amendments, now 31 U.S.C. § 1517, explicitly makes it illegal to obligate in excess of or in advance of, not only the entire appropriation, but in any amount in excess of or in advance of any apportionment or re-apportionment thereof. Therefore, according to the statute, "appropriations available" means "that portion of the appropriation (currently) allotted and available to the requiring activity for payment."

Just as in the case of the obligation violation, however, not everyone in the Government understands or functions as if "available appropriations" referred to only the apportioned part of an appropriation. In expressing his opinion as to what appropriations would be available if DOD were to limit its liability under a certain contingency clause to available appropriations, a DOD Assistant General Counsel stated that such limiting language would

limit [the Government's] obligation to an entire appropriation such as the Navy or Air Force Aircraft Procurement account. We are concerned with such a broad obligation exposure and suggest that serious consideration be given to adding language which would limit obligation exposure to that portion of the

appropriation allotted and available to the requiring activity for payment...³⁸

The Assistant General Counsel's understanding of the concept of "available appropriations" is, then, not the Act's understanding of the phrase. However, his position represents a common understanding of the law. Even GAO seems to believe that by pledging "available appropriations" an entire year's entire appropriation would be vulnerable. This can be evidenced from the scenario they postulate in 62 Comp. Gen. 361 (1983). There they refer to an Army contract which provided for indemnification to New York State militiamen for injuries incurred while providing guard services at the Winter Olympic Games. The Army had included an indemnity clause using the GAO recommended form of limiting liability to available appropriations.³⁹ Evidently only a single militiaman was injured and no liabilities devastated the appropriation. But, GAO hypothesizes:

If, on the other hand, the accident took place in the beginning of the fiscal year and (let us assume) a large number of militiamen were injured simultaneously, the payment of the indemnity obligation might well wipe out the entire unobligated balance of the appropriation for the rest of the fiscal year. This would certainly frustrate the intent of the Congress...⁴⁰

Thus, GAO seems to be employing a broader definition of "available appropriations" than the Act would do. This is in spite of the fact that GAO at least recognized the problem almost a year earlier in B-206626, July 27, 1982. Commenting to the DAR Council Director on its misgivings about its own limitation language solution, GAO said:

For instance, even with the limiting language we have suggested in the indemnification clause, a loss could occur that would require payment from available

unobligated appropriations in amounts so great as to leave some agencies with nothing to carry out other functions normally funded from that appropriation during the remainder of the fiscal year. This would necessitate a deficiency appropriation request to allow the agency to continue to operate, and a question could be raised as to whether [the Anti-Deficiency Act] had been violated [in its sections specifically making illegal obligations in excess of apportionments or reappropriations]. (Emphasis added.)⁴¹

Those sections of the Act do more than raise questions. They, in fact, state clearly that obligations in excess of apportionments are illegal. There is no difference between an entire appropriation and any apportionment of it for purposes of the Anti-Deficiency Act. The apportionment sections only more specifically define the concept of "available appropriations" as the term is used in 31 U.S.C. § 1341(a), "amplifying and enforcing"⁴² that section. Still both OSD Assistant General Counsel and GAO, for example, seemed to think on those occasions, at least, that the Anti-Deficiency Act has nothing to say about obligations in excess of or in advance of apportionments of appropriations.

3. The "unless authorized by law" Exception.

The Act states that obligations in advance of appropriations are not allowed "unless authorized by law."⁴³ Thus, the Act recognizes Congress' prerogative to create obligations in advance of appropriations. (The Constitution prohibits expenditures absent an "appropriation made by law."⁴⁴) The law surrounding the exception has been summarized as follows:

The statute relied upon to invoke the Anti-Deficiency Act exception "authorized by law," must require an agency to take a specific action, or follow a course of action, that results in obligations which ultimately

exceed an appropriation or otherwise create a deficiency. Further, where the Congress intends to authorize administrative officers to incur obligations in excess of appropriations "...such authority is generally given in clear and unmistakable terms." However, Congressional history can be relied upon to establish the necessary Congressional intent. Where such authority is found, obligations incurred are "otherwise authorized by law" and do not violate [the Anti-Deficiency Act]. Absent such "unmistakable" intent, a violation of [the Anti-Deficiency Act] will result. (Citations omitted.)⁴⁵

One of the most commonly cited examples of the use of the exception is 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, transportation, or medical and hospital supplies, which however, shall not exceed the necessities of the current year. (Emphasis added.)

The rationale for this exception was briefly discussed in the dissenting opinion of the U.S. Supreme Court case, The Floyd Acceptances:

[C]ontracts for the subsistence and clothing of the Army and Navy by the Secretaries are not tied up by any necessity of an appropriation of law authorizing it. The reason for this is obvious. The Army and Navy must be fed, and clothed, and cared for at all times and places, and especially when in distant service. The Army in Mexico and Utah are not ⁴⁶ to be disbanded and left to take care of themselves.

This is an example of "contract authority." "Contract authority" is a term of art that refers to statutory authority which specifically authorizes an agency to enter into a contract or other obligation prior to enactment of the applicable appropriation. Its definition as given

in OMB Circular A-34 is: "Statutory authority under which contracts or other obligations may be entered into prior to an appropriation (liquidating cash) for the payment of such obligations."⁴⁷

Statutory authority allowing the Government to assume contingent obligations without benefit of an appropriation will be discussed in Chapter IV of this paper.

4. Status of Contracts Funded by a Deficient Appropriation or Apportionment.

a. Contractor's Right of Recovery.

It is necessary to consider the status of contracts which are funded from appropriations in a deficient status. Fenster and Voltz analyze the law thusly:

[I]t is clear that a contract which, when entered into, is inadequately supported by appropriations or is made in advance of adequate appropriations is void, ab initio. It is a nullity and of no legal effect....Where a contract [adequately funded when entered into, but subsequently becoming underfunded] is funded from a general appropriation account, the contractor normally is not charged with knowledge of the adequacy of the appropriations to cover his contract, and will be permitted to recover all his costs plus breach of contract damages if the government subsequent to contract formation causes the account to become underfunded.

On the other hand, if the contract is funded from a special or line item appropriation account, the contractor is on notice that only those funds and no more are available, and he will not be allowed to recover in excess of that amount. For the same reason, whenever a contractor has actual or constructive notice, however received, of legal limitations on the amount of funding available to his contract, he will not be allowed to recover in excess of that amount. There is no magical quality about "general appropriations" which confers an absolute right to compensation, or about "special appropriations" which imposes an obligation to respect the ceiling amount. Rather, in every case the key factor is notice of limitations....[I]t is concluded that a contract which

becomes deficiently funded after formation is thereupon and as of that point rendered void.⁴⁸

GAO agrees with this position in that it properly states whether or not the contractor may recover in face of an Anti-Deficiency Act violation. The key is in either actual or constructive notice on the contractor of the limitation of the appropriation involved. GAO cites two lines of cases bearing this out:

In Ferris v. United States, 27 Ct.Cl. 542 (1892), the plaintiff had a contract with the Government to dredge a channel in the Delaware River. The Corps of Engineers made him stop work halfway through the job because it had run out of money. In discussing his rights in a breach of contract suit, the Court held:

"An appropriation per se merely imposes limitations upon the Government's own agents; it is a definite amount of money intrusted to them for distribution; but its insufficiency does not pay the Government's debts, nor cancel its obligations, nor defeat the rights of other parties." Id., at 546.

See also Dougherty v. United States, 18 Ct.Cl. 496 (1883), and two Capehart Housing cases, Anthony P. Miller, Inc. v. United States, 348 F.2d 475 (Ct.Cl. 1965), and Ross Construction Corp. v. United States, 392 F.2d 984 (Ct.Cl. 1968). In the latter two cases, the Court explained that it made a distinction between contractors paid out of a general appropriation and those contracts for which a specific and limited appropriation is made by the Congress. The former are not barred from recovering damages for breach of contract even though the appropriation is exhausted, because the contractor "cannot justly be expected to keep track of appropriations where he is but one of several being paid from the fund." Ross, supra, at 987.

In another line of cases, where the appropriation was specifically made for a particular contract, the contractor was deemed to have notice of the limits on the spending power of the Government official with whom he contracted. See Hooe v. United States, 218 U.S. 322 (1910); Sutton v. United States, 256 U.S. 575 (1921). Such a contract was valid only up to the amount of the available appropriation. If the contract became under-funded due to unexpected expenses of extra work ordered, it was a "nullity" to the extent that

appropriations were exceeded.⁴⁹

Thus, the general rules are stated. Certain exceptions and refinements to these rules will be discussed in the sections on constructive changes⁵⁰ and on termination issues.⁵¹

b. Continuing Rights and Duties of the Parties.

However, while those cases provide general rules as to the extent a contractor may recover in the face of a deficiency, they do not provide the answer to whether or not in the face of a deficiency (of which the contractor has notice) the contract continues to impose any duties upon the contractor or confers any rights on the Government. No cases clearly address this issue. Fenster and Voltz argue that in such a situation there can be no further rights or duties on either party. But, the practice of the Government faced with deficiencies appears to be otherwise.

Fenster and Voltz argue that a contract which becomes deficiently funded after formation is "thereupon and as of that point rendered void."⁵² By "rendered void" they mean, "From that time onward, however, neither the contractor nor the government is at liberty to continue work, and in so doing, to continue to increase the extent of the deficiency."⁵³ In other words, neither party has any rights or duties with regard to the other except for the Government's obligations to pay damages for breach of contract (provided the contractor would be allowed to recover in accordance with the above stated notice rules).

However, GAO and the Army (at least) appear not to be of the position that upon the contract's funding becoming deficient, the Government's right to demand continued performance, or conversely, the

contractor's duty to perform, is affected. This can be evidenced from the advice sought of GAO by the Army in face of the deficiency experienced by the Army in 1975 referred to above.⁵⁴ At least one of the alternatives proposed by the Army and seen as "authorized" by GAO, termination for convenience, presumes that the contracts remained viable, that even in face of the deficiency, they, nevertheless, imposed obligations upon the parties beyond the obligation accruing to the Government for costs of work performed and damages for breach. It would seem that rather than continuing to impose any obligation on the contractor, the sections of the Act prohibiting the acceptance of voluntary services⁵⁵ would require that the obligations of the contractor cease upon the commencement of a deficient funding status.

In another instance the Government took the position that a contractor does not even have standing to assert Anti-Deficiency Act violations.

The Navy's position on standing is that the funding statutes are "internal tools for the use of the government" and thus may not be raised by contractors. Apparently the Navy sees no problem in the fact that it can use these statutes to defeat recovery by innocent contractors:

Although the United States has occasionally relied upon admitted violations of the Anti-Deficiency Act as a defense to other lawsuits involving contractor claims for payment and damages, the courts have had almost no experience with situations in which contractors have attempted to avoid their contractual obligations by alleging violations of the Act.

In short, the Navy can use it to avoid its duty to make payment, in its discretion, but contractors should not be permitted to raise in advance the legal issues which by the Navy's own admission could ultimately⁵⁶ deprive them of recovery. (Citations omitted.)

The essence of the Navy's position in the above matter was that the contractor had no right to stop performance even if the supporting appropriation had become deficient. They argued that only failure to pay the contractor would excuse continued performance, and said, in essence, that the Navy could look to other appropriations to fund the payments when due.⁵⁷ The matter was settled, however, without court decision.⁵⁸

Thus, the issue has not been litigated to the point of decision to date, and the Government's position in these matters frequently seems to leave some portion of the Act unaccounted for.⁵⁹ Therefore, it is not clear in a deficiency situation if the Government may exercise its contractual right to terminate for convenience (or other contractual rights). It is also not settled whether or not the Government may demand continue performance. Conversely, it has not been determined if the contractor is relieved of all contractual obligations by the appropriation becoming exhausted.

c. Contracts with Improper Contingent Liability Provisions.

Specifically with regard to contingent liabilities, it is not clear what is or becomes the status of a contract containing an unauthorized contingent liability provision. 35 Comp. Gen. 85 (1955) is the closest any case has come to dealing with this issue. In that case, the Comptroller General considered a building lease which contained a clause obligating the Government to indemnify the lessor for losses, liabilities, and litigation expenses. The Comptroller General said:

With respect to the indemnity provisions contained in...the lease, it may be stated for your future guidance that obligations of such indefinite and unlimited character consistently have been regarded by the accounting officers as objectionable in the absence of express statutory authority therefor. [Citations omitted.] As admitted by your General Counsel, the General Services Administration has no express authority for undertakings such as contained in...the present lease. In such circumstances and in view of the [Anti-Deficiency Act and the Adequacy of Appropriations Act], it must be held that the contracting officer exceeded his authority in including such provisions in the lease, and accordingly, may not be recognized as imposing any legal obligation on the Government.⁶⁰

Thus, the GAO struck down an indemnity provision of a lease stating that the contingency clause "may not be recognized as imposing any legal obligation on the Government." The question remains, "What, if anything, does it do?" The clause was, after all, ostensibly bargained in good faith. The clause formed one of the assumptions upon which the lease was priced. If that assumption was wrong, does the Government have the obligation to renegotiate the price? Is the lease itself void ab initio? May either party be excused from the lease on account of this illegal provision? Or, because the law says that the Government may not assume the risk, does the lease remain intact at the same price, but with the risk of loss shifted from where the contract said it was (with the Government) to somewhere else (with the lessor)? Assuming the contingency occurs and causes a deficiency in the appropriation, what would be the result? Given the fact that two parties have come to agreement based on these certain terms, GAO does not consider what may be the ramifications of the failure of one of those terms.

In GAO's defense, however, it needs to be pointed out that this is

one of the few cases involving the propriety of an indemnity clause in which the Comptroller General was issuing his opinion after the fact. In most other instances where GAO was asked a question about the propriety of an indemnity provision, it was done in advance of making the obligation. Nevertheless, this approach is evidence of a lack of consideration on the part of GAO that what is at stake in these opinions is the legal status of a bi-laterally negotiated and executed contract.

5. Failure to Apply the Anti-Deficiency Act Even in Factually Similar Situations.

Finally it needs to be pointed out that not every situation which has presented contingent liabilities for the Government has been decided in the context of the Anti-Deficiency Act. The most curious of these is found in 20 Comp. Gen. 632 (1941).

In that case, the Army had entered into a cost plus fixed fee contract providing for reimbursement to the contractor for losses sustained in connection with the work. A loss was sustained and the contractor submitted a voucher for payment. The disbursing officer questioned the legality of payment, not on the basis of the Anti-Deficiency Act, but on the strength of an earlier GAO opinion, 18 Comp. Gen. 285 (1938). That opinion stands for the proposition that contract stipulations which may increase the cost of performance are unauthorized unless reasonably requisite to the accomplishment of the purposes of the appropriation involved, or unless specifically authorized by statute. The disbursing officer simply questioned whether or not the liability was reasonably requisite to the accomplishment of

the appropriation involved. (There was also a question about the extent of a disbursing officer's authority to settle claims.) In essence the Comptroller General said that reference to 18 Comp. Gen. 285 was inapposite; that payment was authorized because this was a cost type contract; and that cost type contracting was specifically authorized by the act of July 2, 1940 (Public No. 703, 76th Congress). The Comptroller General said:

[T]he contract basically contemplates that the actual cost of the whole work and the risk thereof are to be assumed by the Government; that is, that the contractor is to come out whole, regardless of contingencies, in performing the work in accordance with the contract and the directions and instructions of the contracting officer, plus only a limited fixed fee....[T]here is no margin included in such fee to compensate the contractor for the risks and contingencies of work of such character and magnitude which ordinarily are assumed by a contractor and covered by the contract [fixed] price. The provision...that the Government will reimburse the contractor for premiums on bonds and insurance policies which the contracting officer may require for the protection of the Government or may approve as reasonably necessary for the protection of the contractor, indirectly imposes the cost of such risks on the Government, and further demonstrates that the Government and not the contractor is to bear the risks involved in the performance of the contract. The express inclusion in such provision of public liability employer's liability, and fidelity insurance shows that the Government is thus indirectly to assume even the risk of insurable losses resulting from the negligence or defalcations of the contractor's employees. To make certain that the contractor does come out whole, regardless of contingencies, the contract expressly provides...that the contractor shall be reimbursed...for "Losses and expenses, not compensated by insurance or otherwise * * * actually sustained by the contractor in connection with the work,"....The purpose, of course, is by thus assuming the risks and, in effect, guaranteeing the contractor against loss, to procure the work for the United States at actual cost, plus only such a comparatively small fixed fee for the contractor's services, etc., as would be appropriate under such conditions. Such provisions are thus of the essence of "cost-plus-a-fixed-fee" contracts, the use

of which is expressly sanctioned by the act of July 2, 1940, supra, and so are not contrary to the principles of the decision, 18 Comp. Gen. 285. (Emphasis added.)⁶¹

The issue was not addressed to the Comptroller General on the basis of Anti-Deficiency Act concerns nor did he of his own accord analyze the situation as being one in which the Government was liable for indefinite and uncertain sums which may exceed the appropriation. He says rather that the essence of cost contracting is that the Government assumes all risks. If a certain risk becomes an actual liability, it is just another cost on a cost contract; and cost contracting was authorized by statute. Nothing indicates that the contract contained any provision analogous to the present limitation of costs or funds clauses.⁶² But, the presumption of the Comptroller General that the Government was to assume the risk of all contingencies in cost contracting suggests that he did not understand that assumption of risk was to be limited in amount to so much money as had been obligated for the performance of the work.

48 Comp. Gen. 361 (1968) is another case where GAO approved of the Government contractually assuming a contingent risk without reference to the Anti-Deficiency Act. It should be remembered that these cases predate B-201072, May 3, 1982, declaring the Insurance--Liability to Third Persons clause illegal. Since the time of these earlier cases, GAO's thinking may have come into sharper focus. However, in 62 Comp. Gen. 361 GAO attempted to rationalize the above and other earlier cases into a logical consistency with B-201072.⁶³ This attempt leaves a question as to the breadth of the application of the rule regarding

contingent liabilities as reiterated in both B-201072 opinions. Furthermore, if GAO's rationalizations are correct and the Comptroller General has not refined his thinking with regard to the application of the Anti-Deficiency Act to contingent liabilities, then the question is left open whether or not the Anti-Deficiency Act might be ignored in any given situation, even today.

D.

WHAT THE ACT MEANS FOR CONTINGENT LIABILITIES

The previous section has emphasized for the reader certain features of the Act which are important for the following discussion. But, in so doing, it has also alerted him to the fact that individuals in the organizations most concerned about the Act, including the one most frequently making decisions concerning it, GAO, do not always seem to appreciate the full extent of it. Thus, once again, the reader must take this into account in deciding what weight should be given to such principles as can be gleaned from the decisions and opinions cited in what follows. With that warning and caveat in mind the discussion proceeds to consider what the Anti-Deficiency Act means for contingent liabilities.

In fact, the rule has already been stated in the introduction:

[N]o officer of the Government has a right to make a contract on its behalf involving the payment of an indefinite and uncertain sum that may exceed the appropriation, and which is not capable of definite ascertainment by the terms of the contract, but is wholly dependent upon the happening of some contingency the consequence of which can not [sic] be defined by the contract.⁶⁴

GAO reiterated that position time and time again over the years. Its most notable recent reiteration was in B-201072, May 3, 1982. There GAO said, "This Office has consistently held that, unless otherwise authorized by law, [a]...provision in a contract which subjects the United States to an indefinite and uncertain liability contravenes [the Anti-Deficiency Act and the Adequacy of Appropriations Act, 41 U.S.C. § 11]."

The courts have consistently agreed with GAO's statement of the law. The most concise court statement on the matter is to be found in California-Public Utilities Co. v. United States:⁶⁵

The United States Supreme Court, the Court of Claims, and the Comptroller General have consistently held that absent an express provision in an appropriation for reimbursement adequate to make such payment, [the Anti-Deficiency Act] proscribes indemnification on the grounds that it would constitute the obligation of funds not yet appropriated. Chase v. United States, 155 U.S. 489 (1894); Hooe v. United States, 218 U.S. (1910); Sutton v. United States, 256 U.S. 575 (1921); Leiter v. United States, 271 U.S. 204 (1926); Goodyear Co. v. United States, 276 U.S. 287 (1928); Shipman v. United States, 18 Ct. Cl. 138 (1883); City of Los Angeles v. United States, 107 Ct. Cl. 315, 68 F. Supp. 974 (1946); 33 Comp. Gen. 90 (1953); 35 Comp. Gen. (1955).⁶⁶

Although the issue in that case is addressed in the context of indemnity, the reasoning of the case and those cited makes it applicable to all obligations, indefinite and uncertain, dependent upon the happening of some contingency. GAO has recognized this, stating, "The prohibition against incurring indefinite contingent liabilities is not limited to indemnification agreements. It applies as well to other types of contingent liabilities..."⁶⁷ Reason and logic dictate that this should be the case. The objections to indemnification

agreements (that they subject the Government to indefinite and uncertain liability for which there may not be sufficient funds in the supporting appropriation) are common to all contingent liabilities.

In summary, then, the objections to obligating the Government for contingent liabilities posed by the Anti-Deficiency Act are that such obligations are 1) indefinite and uncertain in amount, and 2) may exceed the appropriation. The question then becomes, "If these objections could be overcome, may the Government legally obligate itself for contingent liabilities?" If so, what is the policy for so doing?

In fact, the Government does contractually assume many contingent obligations, and the GAO has developed certain rules for so doing. Additionally, Congress has in several instances enacted statutory authority for the Government to assume contingent obligations as an exception to the Anti-Deficiency Act. The remainder of this paper is given to considering the legal means by which the Government may assume contingent obligations either in spite of the Anti-Deficiency Act or as an exception to it, and to considering the factual situations in which the Government has actually undertaken such obligations.

The Anti-Deficiency Act has provided the rationale to answer most problems involving contingent liabilities. Most of the questions have been raised in the context of the Anti-Deficiency Act and disposed of in the same manner. But, from time to time GAO has recognized another legal problem. For want of another name for it, it will be referred to it as the problem of "statutory authority" to obligate the United States for contingent liabilities. Here the focus shifts from the

Anti-Deficiency Act to 41 U.S.C. § 11 (the "Adequacy of Appropriations Act"), and 31 U.S.C. § 1301 (a).

Before going on to consider how the Government may obligate itself for contingent liabilities in light of the Anti-Deficiency Act, it is necessary to consider how the Government's authority so to do, may be affected by these other constraints.

III

THE PROBLEM OF "STATUTORY AUTHORITY"

IN CONTRACTUALLY ASSUMING CONTINGENT RISKS

The exigencies of the...agencies and of their contractors...demand legal certainty and not a dispute between two Government agencies which may be difficult to resolve.

-Martin F. Richman
Acting Assistant Attorney General
in MEMORANDUM Re:
Statutory authority of Defense
agencies to indemnify their
contractors against uninsurable
risks. (1967)

A.

INTRODUCTION

This chapter considers the question of whether or not "express statutory authority" is a legal prerequisite for the Government to assume contingent risks. It deals with the relationship between specific statutory authority for the Government to enter into contingent obligations and the authority the Government may have to enter into such arrangements as a "necessary expense" of a general appropriation. Either 1) specific statutory authorization, or 2) the determination that the obligation is "reasonably requisite" to the accomplishment of the purposes of the appropriation in theory would provide the Government with the legal authority so to contract. However, there is much confusion in this area, and no logic to GAO's dealing with it over time.

Indemnity is the only area where opinions have been written. The often repeated rule is that "unless otherwise authorized by law," an indemnity provision in a contract is proscribed by the Anti-Deficiency

Act.¹ Thus, on occasion, GAO has denied the agency the right to indemnify because of lack of "express statutory authority" without considering whether or not the indemnity provision might be "reasonably requisite" to the accomplishment of the mission for which the appropriation was made (a "necessary expense"). On other occasions GAO ignored the "express statutory authority" requirement and permitted indemnity provisions because of their obvious relationship to the procurement and because Congress never expressly prohibited the agencies from so contracting.

The author argues that the risks contemplated by indemnity provisions (loss of or damage to contractor property and third party claims) are always "reasonably requisite" to the accomplishment of the purposes of the appropriation. This is so because any buyer might assume that the cost of such risks (either in insurance premiums or otherwise) is factored into the price of goods and services purchased. Thus, these risks are always pricing factors which could hardly be excluded from the cost of accomplishing the purposes of the appropriation. Therefore, the author suggests that (if in good business judgment it makes more sense to assume the risk directly than to pay to insure against it), indemnity provisions should always be considered a "necessary expense" of the accomplishment of the purposes of the appropriation.

GAO recognizes that either theory will justify use of an indemnity provision. It has said, "[F]or an indemnity agreement to be permissible in the first place, it must be authorized either expressly or under a necessary expense theory..." (Emphasis added.)² However, while on

certain occasions GAO has not allowed the use of indemnification provisions because it found no express authorization, it has never provided any rationale for why or when such an agreement may not be a "necessary expense."

By the end of this chapter it is the author's hope that the reader will have discerned a tension between the requirements for either express statutory authority or a "necessary expense." The author is of the opinion that, although never articulated by GAO or otherwise, the key to this tension is in the fact that even if the obligation could be justified on a necessary expense theory, such theory does not provide adequate funding for the assumption of the obligation as required by the Anti-Deficiency Act.

B.

AUTHORITY OF AGENCIES TO CONTRACT: THE REQUIREMENT FOR EITHER
SPECIFIC STATUTORY AUTHORITY

OR

A "NECESSARY EXPENSE"

18 Comp. Gen. 285 (1938) stands for the proposition that contract stipulations which may increase the cost of performance of a contract (contingent liabilities) are unauthorized unless "reasonably requisite" to the accomplishment of the purposes of the appropriation involved or unless specifically authorized by statute.³ Thus, in order for the obligation of the Government to be legal it must 1) be specifically authorized by statute, or 2) be "reasonably requisite" to the accomplishment of the purposes of the appropriation. Either the express statutory authority or the relationship of the expense to the

accomplishment of the purposes of Congress will provide the agency with the legal authority so to contract. The express statutory authorization would operate as the exception to the Anti-Deficiency Act's requirement for an appropriation. (This exception was introduced in Chapter II⁴ and will be further discussed in Chapter IV.⁵) The "necessary expense" theory does not operate as an exception to the requirement for an adequate appropriation.

The requirement for the expenditure to be "reasonably requisite" to the accomplishment of the purposes of the appropriation involved is but one more iteration and application of the "necessary expense" rule.

31 U.S.C. § 1301(a) states:

Appropriations shall be applied only to the objects for which the appropriations were made except as otherwise provided by law.

This does not mean that Congress must express in minute detail exactly how every dollar of an appropriation should be spent:

It is a well-settled rule of statutory construction that where an appropriation is made for a particular object, by implication it confers authority to incur expenses which are necessary or proper or incident to the proper execution of the object, unless there is another appropriation which makes more specific provision for such expenditures, or unless they are prohibited by law, or unless it is manifestly evident from various precedent appropriation acts that Congress has specifically legislated for certain expenses of the Government creating the implication that such expenditures should not be incurred except by its express authority.⁶

This quote embodies the "necessary expense rule." GAO has summarized its application thusly:

For an expenditure to be justified under the necessary expense theory, the following tests must be met:

(1) The expenditure must bear a logical relationship to the appropriation sought to be charged. In other words, it must make a direct contribution to carrying out either a specific appropriation or an authorized agency function for which more general appropriations are available. This is the crucial test. The important thing is not the significance of the proposed expenditure itself or its value to the Government or to some social purpose in abstract terms, but the extent to which it will contribute to accomplishing the purpose of the appropriation.

(2) The expenditure must not be prohibited by law.

(3) The expenditure must not be otherwise provided for, that is, an item that falls within the scope of some other appropriation.

This rule does not require that the expense be "necessary" in absolute terms:

[T]he rule does not require that a given expenditure be "necessary" in the strict sense that the object of the appropriation could not possibly be fulfilled without it. Thus, the expenditure does not have to be the only way to accomplish a given object, nor does it have⁸ to reflect GAO's perception of the best way to do it.

This would seem to indicate that so long as the agency uses good business judgment and does not abuse its discretion, its expenditure would not be considered unauthorized.

C.

CONTINGENT LIABILITIES AND THE "NECESSARY EXPENSE RULE"

With regard to contingent liabilities, the "necessary expense rule" issue has presented itself exclusively in regard to the risk of loss of or damage to contractor property and third party claims (indemnity). Assuming there is no express statutory authority for the Government to assume the risk of such contingency, the question becomes, "May the Government assume these risks nevertheless, i.e., are they "necessary expenses" of the procurement in question?"

As this problem has only presented itself in regard to indemnity, that area may be the only one where it has application. That is, no one has ever questioned the relationship of other contingencies, such as cost escalation, differing site conditions, and the like to the accomplishment of the purposes of the appropriation. The reason is probably that they are obviously pricing factors. Assuming the risk of loss of or damage to contractor property and third party claims, however, has been the subject of many agency questions. In fact, usually on the basis of the Anti-Deficiency Act, the agencies have assumed that they have not had authority to indemnify, and this was the assumption of the Court of Claims in California Public Utilities.⁹

The Anti-Deficiency Act does not have to do with the propriety of the obligation, but with the sufficiency of the appropriation to pay for it. In questions of indemnity, both the GAO and the agencies have concentrated more on the availability of funds (i.e., upon the Anti-Deficiency Act) than upon the "necessity" of the expense.

The risk of loss of or damage to contractor property and third

contract), but to assume the risk directly. The costs of these contractor risks might always be said to be a "necessary expense" of the procurement. This is true whether they are made a matter of contractor risk (against which the contractor would most likely insure or establish a "self-insurance program") or are assumed as a Government risk, and thus eliminated from the cost of the contract. As far as the "necessity" of the contractual consideration of the risk involved is concerned, there is no logical difference between the situation where the contractor assumes the risk or where the Government does. It is no less necessary to consider the risk when it is assumed by the Government than when it is assumed by the contractor. The only difference, as far as the Government is concerned, is that when it assumes the risk, it must ask the question, "Where are the funds to pay for the contingency, should it occur?" Thus, the question is a question of authority only to the extent that such authority is dependent upon an appropriation of Congress for a given purpose, and adequate to fund that purpose. The authority to contract is dependent not only upon an authorization act, but upon an appropriation act as well:

At one time, Appropriation Acts were the only statutory authority required in addition to the statute which created the agency. However, Congress has by rule...and by statute...required that Appropriation Acts be preceded by statutes authorizing the agencies' specific activities. Thus, general authority is contained in legislation creating the agency, specific programs are authorized by "Authorization Acts," and funds for authorized programs furnished by "Appropriation Acts."¹⁴

Until 62 Comp. Gen. 361 the issue of the adequacy of the appropriation to fund indemnification clauses was not addressed by the GAO. There it does so only obliquely stating that probably the appropriation is not adequate to accomplish the purposes for which it was appropriated and to assume directly the risks associated with contractor property and third party claims.

1. Cases Requiring "Express Statutory Authority."

In spite of all that, there have been instances where GAO has directly challenged the agency's authority (as such, not merely the agency's ability to pay) to enter into indemnification arrangements. One such case was B-137976, December 4, 1958. There the National Gallery of Art queried GAO if it could enter into an agreement to indemnify a corporation which was providing air conditioning equipment maintenance training to members of the Gallery's engineering staff. The clause read:

We agree in consideration of the foregoing to protect, hold you harmless and indemnify you, your officers, agents and employees, against any and all suits, claims, loss, damage or expense which may arise by reason of injuries to or death of our employees while in or about your Ampere Works for the above purpose, whether said injuries or death be caused by you, negligence, the negligence of ¹⁵ your officers, agents or employees, or otherwise.

GAO concluded that such an agreement would be improper, stating, "The obligations sought to be created by the agreement are of a nature so remote from training as to be beyond the purview of...that act [authorizing the department head to enter into agreements with non-Government facilities for training]." ¹⁶

GAO held that assuming the contractor's risk of third party claims

was not "authorized" specifically by the statute. There doesn't appear to be any consideration of the "necessary expense" rationale. In fact, the rule as repeatedly stated with regard to contingent liabilities does not include the concept of "necessary expense." It is, "[A]bsent express statutory authority to the contrary the Government may not enter into an agreement...where the amount of the Government's liability is indefinite, indeterminate, or potentially unlimited." (Emphasis added.)¹⁷

The focus is on the emphasized words. There is a tension here between the stated requirement for "express statutory authority" and the above considered "necessary expense rule." The requirement for "express statutory authority" would seem to render the "necessary expense rule" inapplicable.

In B-137976 GAO looked for express statutory authority, found none, and concluded that the "obligations sought to be created...[were] so remote" from the purposes of the Act as not be authorized thereby. Likewise, in 35 Comp. Gen. 85 (1955), the Comptroller General found unauthorized an indemnity provision because of no express statutory authority. In that case the Comptroller General dealt with a building lease which contained a clause obligating the Government to indemnify the lessor for losses, liabilities, and litigation expenses. The Comptroller General said:

As admitted by your General Counsel, the General Services Administration has no express authority for undertakings such as contained in...the present lease. In such circumstances and in view of the [Anti-Deficiency Act and the Adequacy of Appropriations Act], it must be held that the contracting officer exceeded his authority in including such provisions in the lease, and accordingly, may not be recognized as

imposing any legal obligation on the Government.¹⁸

2. Cases Not Requiring "Express Statutory Authority."

In 42 Comp. Gen. 708 (1963), 48 Comp. Gen. 361 (1968), and in 54 Comp. Gen. 824 (1975), the Comptroller General allowed for the use of indemnity provisions. In 42 Comp. Gen. 708 he did so without considering either the "express statutory authority requirement" or employing the "necessary expense rule." In 54 Comp. Gen. 824 he seems to be employing a necessary expense rule exclusively. Nowhere is the problem of the necessity for express statutory authority more highlighted than it is by contrasting 35 Comp. Gen. 80 and B-137976, on the one hand, with 48 Comp. Gen. 361, on the other.

In the latter case the Comptroller General approved of an indemnity provision involving the risk of loss of or damage to contractor property. There the question was the authority of the Selective Service System to pay claims pursuant to an indemnity clause incorporated by reference into its contracts with charter companies hired to transport selective service registrants by bus to their physical examinations.

GAO observed that:

All motor carrier charter coach tariffs to which our attention has been directed contain an indemnity provision reading substantially as follows:

Each vehicle assigned for Charter Service will be in good condition, including the condition of window glass and seats. Any damage to the vehicle caused by the "Charter Party" will be charged by the Carrier to the "Charter Party."

Therefore,...the contract between the System and the carriers does obligate the System for any damage to the vehicle, ordinary wear and tear excepted [a contingent liability], unless that contract is unauthorized.

The basic statute...is silent concerning the

transportation of selectees. However, the appropriation acts from the first have provided funds under language reading substantially like this:

Salaries and Expenses: For expenses necessary for the operation and maintenance of the Selective Service System * * *.

From this provision the authority to contract for the travel of selectees is derived. And we find no express limitation on this authority....Under similar circumstances the courts have held that the authority to contract, in the absence of express limitation, includes authority to agree to the customary provisions....Therefore, in the absence of express statutory limitation, and since the amount of the potential liability is of necessity limited to the value of the motor carrier's equipment and is not indefinite or unlimited..., we conclude that the Director of the System has authority to agree to an indemnity provision like the one quoted above which appears to be a standard provision in all motor carrier charter coach tariffs. (Emphasis added.)¹⁹

GAO went on to note that unpublished internal Government regulations prohibiting the System from agreeing to any such indemnification could not affect contracts containing the provision, and that absent a re-negotiation of the entire "Selectee Passenger Agreement," the Government may be liable for the damage in any case. Finally, the Comptroller General concluded:

However, assuming the applicable tariff contains an indemnity provision substantially as set out above and that the charter certificate referred to above without alteration in that regard was executed, it is our view that claims from motor carriers for compensation for damages to vehicles caused by registrants who have been transported in Charter Coach Service for the system, in any otherwise proper case, are required to be allowed and paid. (Emphasis added.)²⁰

3. The "Necessary Expense" Rule and the Anti-Deficiency Act.

Thus, in that case GAO allowed for the use of the indemnity provision, and did so without considering the Anti-Deficiency Act. In fact the Act is never mentioned as such in the opinion. We are never sure what is the relationship of the Anti-Deficiency Act to these situations. The Anti-Deficiency Act states that the Government may not be obligated in excess of available appropriations or in advance of appropriations unless authorized by law.

It must be emphasized that to constitute an exception to [the Anti-Deficiency Act], the "contract authority" [the "authorized by law" exception to the act] must be specific authority to incur the obligation in excess or advance of appropriations, not merely the general authority any agency has²¹ to enter into contracts to carry out its functions.

This is GAO's understanding from cases at least as far back as 1955.²² This would indicate that the indemnity provisions in question did not fall within the unless otherwise "authorized by law" exception of the act. The Anti-Deficiency Act would thus appear to prohibit this indemnification provision because the only authority the agency had was the general authority it had to contract to carry out its functions. However, GAO approved the indemnity provision because the "general authority" of the System to pay necessary expenses did not expressly prohibit indemnity. GAO does not consider what happens when a legally recognized "customary provision" of charter service contracting conflicts with an express statutory limitation on contracting in excess of appropriations. Is express authority necessary to allow indemnification (as in other cases) or (as this case would have it), must express authority limit the agencies' ostensible discretion to

indemnify at least against losses not unlimited in amount? In other cases, GAO said that without express statutory authority allowing indemnification, the practice was illegal. In 48 Comp. Gen. 361 and in 42 Comp. Gen. 708 they said that because the general authority to enter into contracts did not prohibit it, and because it was a common commercial practice, indemnification was legal.

Thus, once again it is not possible to state with certainty exactly when or if the stated requirement for express statutory authority applies or when some other logic might be brought to bear. From 54 Comp. Gen. 824 until 62 Comp. Gen. 361 there are no instances where GAO found unauthorized an indemnity agreement because of a lack of express statutory authority. Yet the rules as stated in 54 Comp. Gen. 824 were applied in various cases.²³

4. The "Express Statutory Authority" Requirement Revisited.

In 62 Comp. Gen. 361 GAO again brought up the issue of express statutory authority. That opinion is the reconsideration of its earlier opinion, B-201072, May 3, 1982, finding illegal the Insurance Liability to Third Persons Clause. In the 1982 opinion GAO stated an indemnity clause may be legal only if recovery pursuant to it is limited in amount to appropriations available at the time the loss occurs. It recommended limiting language which was made part of the clause in the Federal Acquisition Regulation (FAR), effective April 1, 1984:

The Government's liability under...this clause is subject to the availability of appropriations at the time a contingency occurs. Nothing in this contract shall be construed as implying that the Congress will, at a later date, appropriate funds sufficient to meet deficiencies.²⁴

However, upon reconsideration, GAO apparently believes that its limiting language does not solve the problem of a requirement for express statutory authority. Its "tentative position" therein stated espoused a requirement for express statutory authority. Here, the distinctions between law and policy become lost in some very muddled language. GAO's opinion is less than forthright as to whether its "tentative position" requiring express statutory authority is one of policy or of law.

In B-206626, July 27, 1982, evidently on its own initiative, GAO wrote the director of DAR Council and the Administrator of the Office of Federal Procurement Policy (OFPP) about its decision prescribing the solution of adding the above quoted limiting language to the Insurance--Liability to Third Persons Clause. GAO stated its concern about the policy generally of obligating the United States to indemnify contractors:

Since the potential liability of the Government created by open-ended, indefinite indemnification clauses is so great, we believe [sic] that any such authority should be viewed as an exception from the basic legislative policy that no Government agency should enter into financial commitments, even though contingent in nature, without an appropriation to cover them. Exceptions from this policy should be narrowly construed. Expansion of existing exceptions, even where there is legal support for doing so, should be undertaken only with the greatest caution. (Emphasis added.)²⁵

GAO reiterated this position in slightly stronger terms regarding the law or policy issue nearly a year later in the published opinion, 62 Comp. Gen. 361. In the above opinion, GAO implied that "legal support" could be found for indemnification provisions without express

statutory authority. But, in 62 Comp. Gen. 361 GAO said:

It is our tentative position that even if contract indemnification clauses are rewritten to meet the minimum requirements of the Anti-Deficiency Act, there should be a clear Government-wide policy restricting their use. Since the potential liability of the Government created by open-ended, indefinite indemnification clauses is so great, we think that any such authority should be viewed as an exception from the basic legislative policy that no Government agency should enter into financial commitments, even though contingent in nature, without an appropriation to cover them. Exceptions to this policy should not be made without express Congressional acquiescence, as has been done in the past whenever the Congress has decided that it was in the best interests of the Government to assume the risks of having to pay off on an indemnity obligation. [citing several statutes.] In other words, our tentative position is that open-ended, indemnification clauses should only be permitted when an agency has been given statutory authority to enter into such an arrangement. (Emphasis added.)²⁶

In the space of a year, GAO went from saying exceptions should be narrowly construed--whatever that may mean--to saying they should only be permitted when "statutory authority" has been given.

5. Problems of Law and Policy.

Notice how haltingly GAO came to the conclusion that specific statutory authority is necessary to assume contingent contractual obligations. This unassured hesitation becomes even more pronounced if we compare and contrast the above quoted opinion with an earlier pronouncement. In 1982 GAO said, "If an agency thinks that indemnification agreements in a particular context are sufficiently in the Government's interest, GAO's preference is for the agency to go to Congress and seek specific statutory authority." (Emphasis added.)²⁷ That seems clearly to leave the matter within the realm of agency policy. Then in the last quote above GAO almost seems to be

saying that "as a policy matter, legislation is necessary." It is as if the policy could change and make legislation unnecessary. But, without specific legislation, what is the authority for assuming unfunded contingent obligations? The only known alternative to express statutory authority is the necessary expense theory. Even if it were clear how the express statutory authority and necessary expense interrelated, the latter theory would still have the problem that any contingent liability concededly a "necessary expense" must be supported by a reservation of funds in an appropriation. This is required by the Anti-Deficiency Act.

6. Problems of Inadequacy of Appropriations to Fund Contingent Liabilities.

Without express statutory authority, legal authorization, there must be an appropriation adequate to support the liability. This is required by the "Adequacy of Appropriations Act", 41 U.S.C. § 11, which provides, "No contract or purchase on behalf of the United States shall be made, unless the same [1] is authorized by law or [2] is under an appropriation adequate to its fulfillment..."

Without being "authorized by law", the only way the adequacy of appropriations can be assured is if funds are identified for the maximum liability under the contract.²⁸ However, to do so in the case of contingent liabilities, the Government would be setting aside appropriated dollars to cover a potential liability it hopes would never become actual, and therefore, dollars it would never spend. Congress usually appropriates money to spend on given purposes, not to act as an insurance pool. On those few occasions when Congress was made

aware of the agencies' setting aside of funds for contingent liabilities, it has chosen not to fund the reserve.²⁹ The agencies also have an aversion to tying up money that could only be spent on a contingent liability.³⁰ But, unless money is set aside within an appropriation for the entire maximum liability, it can never be said with legal certainty that the appropriation will be adequate to bear the liability in the event it should become actual. Insofar as any given appropriation may not have budgeted for or been funded with money the agency hopes never to have to spend, it may be argued that if such appropriation supports an indemnity provision, not only the Anti-Deficiency Act, but 41 U.S.C. § 11 has been violated as well. That is, by implication, if Congress has appropriated one hundred percent of an appropriation for certain purposes, none of which includes dollars for potential indemnification liability, then it has provided neither contract authority nor an appropriation adequate for that purpose.

All of this is implicit in GAO's discussion of the issue in 62 Comp. Gen. 361. Once again referring to the Army contract which, using the GAO limitation of liability form, provided for indemnification to New York State militiamen for injuries incurred while providing guard services at the Winter Olympic Games, GAO stated:

If, on the other hand, the accident took place in the beginning of the fiscal year and (let us assume) a large number of militiamen were injured simultaneously, the payment of the indemnity obligation might well wipe out the entire unobligated balance of the appropriation for the rest of the fiscal year. This would certainly frustrate the intent of the Congress, which was to support a winter Olympics program. Whether it would be feasible to rescue the program with supplemental appropriations is problematical, in view of tight budgetary restrictions. At best, the pressures brought to bear on the Congress are precisely the "coercive

deficiency" pressures which...the Antideficiency Act
was enacted to eliminate.³¹

In other words, is it legal for the intent of Congress (to buy certain goods and services from a given appropriation and not to have to fund "coercive deficiencies") to be made contractually dependent upon the whim of the chance of a contingency happening? On the other hand, is it possible to contract, using the best business judgment available, without deciding how best to deal with certain legitimate contingent risks? Therein lies the tension between a risk which potentially may be a reasonably requisite necessary expense, on the one hand, and a lack of dollars on the other.

7. The Implication of Express Statutory Authority in Certain Areas.

This problem may also be looked at another way by reference to the fact that Congress has provided legislation authorizing certain indemnity provisions. This may be some evidence that Congress doesn't envision the Government becoming obligated without its specific authorization. Otherwise, there would have been no need for the legislation. The implication of having "express statutory authority" in some areas is that it may be required in others.

This was the position taken by the Department of Justice in 1967. An Acting Assistant Attorney General observed the Comptroller General's rulings that indemnity agreements violated the Anti-Deficiency Act and then stated:

[I]t appears that Public Law 85-804 has the effect of enabling the President to exempt indemnity agreements of defense agencies from the operation of the Anti-Deficiency statutes; in other words, it restores to the contracting officers of the United States a power which they would have but for the enactment of those statutes. (Emphasis added.)³²

That is, the Anti-Deficiency Act created a requirement for express statutory authority.

That same memorandum realizes the propriety of contractually dealing with these risks. In other words, it is of the opinion that obligating the Government to assume such risks would not violate any "necessary expense rule":

Contractors are, of course reluctant to engage in work for the Government unless they are protected against the risks of the operation, especially if it is highly hazardous; moreover, insurance premiums are a cost element which is ultimately borne by the Government. In many instances, it is therefore impossible to induce contractors to perform this type of work unless the United States agrees to hold them harmless from damage and liability. Similar considerations apply where insurance is available but only at high rates. Here it may be advantageous to the Government to agree to indemnify the contractors and to assume the risk in the form of self-insurance.

The question therefore arises whether it is within the power of the defense agencies to enter into such indemnity agreements....

Apparently there is no statute which in terms prohibits the conclusion of indemnity agreements by or on behalf of the United States. The agreements here contemplated, however, potentially subject the United States to indefinite and virtually unlimited liabilities which may exceed the funds appropriated for the contracts to which the indemnity clauses are attached [in violation of the Anti-Deficiency Act].³³

C.

CONCLUSIONS

The problem, then, may not be one simply of a lack of express statutory authority or want of good business judgment in deciding to assume any given risk. But rather, the problem may be that no dollars have been budgeted or appropriated for liabilities nobody hopes (or even expects) will be incurred.

The implication of stating that "Without express statutory authority or an appropriation adequate therefor, the Government may not obligate itself for contingent risks" is that then such risks must always be borne directly or initially by the contractor. The Government could expect contractors' prices always to include the cost of insuring against the risk or an amount hedging against the occurrence of the contingency. If the risk were extremely great, perhaps contractors would not take the job at any price.

As stated above, Government policy recognizes and approves of paying the cost of insuring against given risks. The problem occurs when, for whatever reason, the Government concludes it would be in its best interest to assume the risk directly rather than paying the cost of insurance or otherwise paying a premium for having the contractor assume the risk. And, that problem is one of dollars, available appropriations. Whenever the GAO or the agencies have recognized a "dollar" problem, they have usually concluded that, without express statutory authority, there was no authority to enter into the agreement.³⁴ What has added confusion to the issue is that GAO has come down on both sides of the authority issue, sometimes saying it was

required and sometimes saying it wasn't, without considering the funding problem.

In any event, to date the FAR has not gone along with GAO's proposal (whether motivated by law or policy) to restrict the use of indemnity provisions to those areas where Congress has provided express statutory authorization. The FAR requires the use of the Insurance--Liability to Third Persons Clause, 52.228-7 in cost contracting.³⁵

The issue has stirred considerable debate³⁶ and given impetus to several statutory proposals for indemnity.³⁷ Thus, the matter remains largely unsettled.

To date, this issue has been dealt with solely in regard to indemnity. However, the problem is not theoretically limited to indemnity. The logic of it should apply for any contingent liability for which funds have not been identified in an appropriation and reserved. But, the Comptroller General presently requires that without "express statutory authority" or a reservation of funds to pay for the contingency, the Government's liability must be a limited.³⁸ Therefore, any contingent obligation, even one limited in amount, could have a problem with the legal authority for it to the extent that there may be no funds appropriated (and reserved) on its account. This, once again, is because the authority of the Government to contract is dependent not only upon statutory authorization, but also upon an adequate appropriation for the contractual undertaking.

IV

HOW THE GOVERNMENT MAY ASSUME CONTINGENT OBLIGATIONS
WITHOUT VIOLATING THE ANTI-DEFICIENCY ACT

The Lawyer's truth is not Truth, but consistency or a
consistent expediency.

-Thoreau

The objections of the Anti-Deficiency Act to the Government's assumption of contingent liabilities are that such assumption of liabilities subjects the Government to liabilities which are indefinite and uncertain for which there may not be adequate funds to pay in the event of the occurrence of the contingency.¹ In the past, GAO has not objected to obligating the Government for contingent liabilities where these objections could be overcome. This could be done by 1) limiting the Government's liability in amount to "available appropriations," 2) establishing a contingency reserve to fund the liability, or 3) a combination of the two. Use of these mechanisms presumes that the Government had the authority so to obligate the Government pursuant to the "necessary expense rule" discussed in Chapter III. There is another means by which the Government may legally obligate itself for contingent liabilities. It is the exception built into the Anti-Deficiency Act itself. The Act provides that no obligation or expenditure may be made in excess of or in advance of appropriations "unless authorized by law."² It is not necessary to consider the "necessary expense rule" with regard to such obligations because the relevant statute itself provides the "express statutory authority" whereby such obligations may be assumed. Finally, GAO has allowed the Government to obligate itself for a contingent liability in

a very limited circumstance which might be called the "necessity exception." This chapter discusses each of these legal means by which the Government may assume contingent risks.

A.

LIMITATION OF LIABILITY CLAUSE

1. The Theory of a Limitation of Liability Clause.

Aside from 20 Comp. Gen. 632, 21 Comp. Gen. 149 (1941), and 22 Comp. Gen. 892 (the early cases discussing the relationship between cost contracting and the assumption of risk of loss of or damage to contractor property and third party liability),³ and the "necessity exception" discussed below,⁴ the Comptroller General has never approved of the Government assuming a contingent liability which was unlimited in amount. However, in a number of situations he approved of assuming such risks where the maximum amount of the Government's liability could be determined. For example in 42 Comp. Gen. 708 and in 48 Comp. Gen. 361, he approved of the Government's assumption of the risk of loss of or damage to contractor property. The theory was that the risk was not unlimited, but could be discerned in its maximum amount by reference to the total value of the property in question. However, in 54 Comp. Gen. 824 GAO put restraints on the circumstances under which the Government could assume such risks.

In that case the Navy had asked about the propriety of agreeing to indemnify a contractor for loss of or damage to the contractor's property in lieu of paying for insurance as a cost of the contract. The overwhelming majority of the contractor's work was for the Government. Originally the issue was not indemnity, as such, or the requirement for

either limiting Government liability or establishing a contingency reserve. Rather, the question had to do with the propriety of assuming the risk of loss of contractor property where the contractor performed both Government and commercial work. Normally a contractor is required to segregate its costs so the Government only pays those costs allocable to its work. But, in this case, it was impossible to segregate the commercial work because of the extremely high Government to commercial work ratio.

While GAO approved of the principle of indemnification in that situation, provided it was determined that such an arrangement was in the best interests of the Government, it put a practical limitation on the indemnity option by refining its earlier positions thusly:

As you no doubt are aware, we have in a number of cases disapproved of agreements to indemnify usually on the basis of [the Anti-Deficiency Act and the Adequacy of Appropriations Act], for the reason that the agreements would subject the United States to a contingent liability in an indeterminate amount which could exceed the appropriation. See 7 Comp. Gen. 507 (1928) and 16 *id.* 803 (1937). While in the situations referred to in the Department's letter the maximum indemnity liability is apparently determinable (the fair market value of the contractor's property), it is of course conceivable that the indemnity payments could be of such magnitude as to exceed available appropriations. In such case there would be need for deficiency appropriations to fully cover property losses because of the prohibition against entering into obligations in excess of the funds available. See [the Anti-Deficiency Act]. Accordingly, any contracts providing for assumption of risk by the Government for contractor-owned property must clearly provide that: (1) in the event that the Government has to pay for losses, such payments will not entail expenditures which exceed appropriations available at the time of the losses; and (2) nothing in the contract may be considered as implying that the Congress will, at a later date, appropriate funds sufficient to meet deficiencies. Absent inclusion of provisions along these lines, the Department will have to obtain

legislative exemption from the application of the statutory prohibitions against obligations exceeding appropriations....To the extent our answer to question three [regarding whether or not a contingency reserve was required] in 42 Comp. Gen. 708 (1963) is contrary to what is⁵ set forth in this paragraph, it is overruled.

The limitation of liability provision does not address the Anti-Deficiency Act problem of the indefinite and uncertain obligation, as such. However, whatever the liability might be, or become, it could never exceed available appropriations, because of the limitation clause. This is what "prevents" the violation.

2. The Relationship of Limitation of Liability to Administrative Reservation of Funds.

One has to assume that the courses of action of limiting liability or administratively reserving funds are presented as alternatives. That is, the Government buying activity must either establish a contingency reserve (commitment) equal in amount to its maximum liability (and contractually limit its liability to that liquidated amount) or let the contractor assume the risk of availability of appropriations by insertion of the proviso limiting liability generally to available appropriations. If a reserve is set up and it is contractually agreed that the reserved amount is the limit of Government liability, then there would be no need for a general limitation. On the other hand, if no reserve is set up, then the contractor must assume the risk of the adequacy of the appropriation to meet all its contractual commitments.

While it is not clear from 54 Comp. Gen. 824 that GAO meant these actions to be alternatives, its later opinion, 60 Comp. Gen. 584 (1981), makes it clear that such is the case:

Since risk of loss provision in "installment purchase plan" and incorporated into contract imposes on agency risk of loss for contractor-owned equipment, agency should have either obligated money to cover possible liability under risk of loss provision or specified in contract that such losses may not exceed appropriation at time of losses and nothing in contract is to be considered as implying Congress will appropriate sufficient funds to meet deficiencies. (Emphasis added).⁶

3. Requirements of a Limitation of Liability Clause.

In considering the legality of the standard indemnity clause, Insurance--Liability to Third Persons as it was then constituted, GAO mandated the use of a limitation of liability provision in the clause. In B-201072, May 3, 1982, GAO responded to a question which was presented to it by the Department of Health and Human Services. Health and Human Services questioned whether or not the clause was legal. In a short two page opinion GAO reiterated the legal objections to indeterminate contingent liabilities and restated the requirements of a limitation of liability clause:

This Office has consistently held that, unless otherwise authorized by law, an indemnity provision in a contract which subjects the United States to an indefinite and uncertain liability contravenes [the Anti-Deficiency Act and the Adequacy of Appropriations Act]....The [Insurance--Liability to Third Persons Clause] falls squarely within those contractual obligations which are prohibited under the acts. It seeks to commit Government funds for the payment of liabilities which are undetermined at the time of contracting and whose cost may exceed available appropriations. We know of no statutory authority which would except the clause from [the Acts].

Thus, the present...clause should not be used. We have suggested revised language in our prior decisions, however, which would make an indemnification clause acceptable....The clause should limit the extent of the Government's liability to appropriations available at the time a contingency arises and should explicitly provide that nothing may be construed as implying that

the Congress will, at a later date, appropriate funds sufficient to meet deficiencies.

Thus, the requirements on a limitation of liability clause are that it must 1) limit liability to available appropriations at the time a contingency arises, and 2) specifically state that in the event of a deficiency, nothing should be construed as implying that Congress will fund the deficiency. The contractor must totally assume the risk of the availability of funds to pay the obligation, should it arise.

4. Problems Raised by GAO Limitation of Liability Concept.

a. Is it an obligation "in advance of" appropriations?

This solution presents several problems. First of all, there is the question of exactly what has been obligated at the time of contract execution. If there has been an obligation of such funds as might be available at the time a contingency arises, has there been an obligation in advance of future year's appropriations or apportionments of current year appropriations? The Government is obligated to obligate whatever it has available at the time the contingency occurs. It is GAO's position that there is no obligation in advance of appropriations because no obligation comes into being until the contingency occurs.⁸ However, an obligation to make an obligation is an obligation. It would seem that the clause obligates the Government to an indeterminate amount (up to the unobligated balance of the relevant account) in advance of the availability of the appropriation (should the loss occur in a subsequent year) or any apportionment of the current appropriation. Arguably, this is a violation of the Act.

Even if the limiting language saves the contingent liability from a

technical violation of the Anti-Deficiency Act, it would seem that tying up future available appropriations violates the spirit of the Act. This same principle was criticized by GAO in its discussion of the indemnity provision used by the Army in the Winter Olympic Games case.⁹ The appropriation, even at the time the contingency occurs, could become exhausted, thereby leaving the agency without funds to continue to operate for the remainder of the year, and thus forcing a deficiency appropriation.

b. What is meant by "available appropriations"?

There is also the question of what constitutes "available appropriations"? Is it the entire appropriation for the entire program or fiscal year in question, or is it only so much thereof as has been apportioned? The problem involved here has been discussed in Chapter II.C.2. The Act makes the apportionment the relevant account to determine Anti-Deficiency Act violations. But, GAO and OSD Assistant General Counsel apparently understand differently.

c. Limitation of liability without reservation of funds may be a "naked promise."

Finally, there is the practical problem that limitation of liability to an amount solely dependent upon whatever amount happens to be in the appropriation at the time a loss occurs "may offer only illusory benefits to the contractor."¹⁰ In 62 Comp. Gen. 361 (1983) GAO refers to a letter from the Public Contracts Law Section of the American Bar Association criticizing the limitation of liability approach as being only a "naked promise."¹¹ GAO agreed with the criticism.¹² Thus, even if the limitation of liability clause does

avoid a technical violation of the law, neither the Government nor the contractor can take comfort in the practical effect of it. On the one hand, if there is money in the appropriation at the time a loss occurs, the agency may find itself without funds to fulfill the remainder of its mission. Furthermore, Congress would be placed in the position of having to decide whether to fund a deficiency, or to let the mission go undone. On the other hand, if there is no money in the appropriation, the contractor would have to bear the loss.

B.

ADMINISTRATIVE RESERVATION OF FUNDS

1. The Theory of an Administrative Reservation of Funds.

54 Comp. Gen. 824 also stands for the proposition that creating an administrative reservation of funds to liquidate a contingent liability in the event of its occurrence would meet the requirements of the Anti-Deficiency Act.¹³ The use of an administrative reservation of funds has only been approved in cases where the maximum amount of Government liability could be determined.¹⁴ The theory is that by having funds reserved to discharge a contingent liability obligation, the agency will not exceed available appropriations. Thus, there would be no violation of the Anti-Deficiency Act. One obvious problem with this theory is that unless the maximum amount of Government liability is agreed to in the contract as a liquidated amount, the Government would be assuming the risk that its estimate of the liability is correct. If it is wrong, an Anti-Deficiency Act violation may result.

2. The Legal Requirement and Accounting Practices.

It should be noted that by establishing the requirement for an administrative reservation of funds, GAO departed from its earlier ruling in 42 Comp. Gen. 708. There, the GAO approved of an indemnity arrangement in a rental agreement between the Federal Aviation Administration (FAA) and a lessor of aircraft. In response to a question about such a reserve GAO stated that the FAA did not need to establish a contingency reserve fund equal to the value of the aircraft because:

Where a clause of this nature is included in a contract, there is always the possibility of payment thereunder being required. This bare possibility alone is not sufficient to require recognition thereof by establishment of a reserve, unless and until some circumstance arises from which it is¹⁵ apparent that a demand under the clause may be made.

Such is the rule of business and of accounting. Essentially, the balance sheet doesn't show a contingency as a liability unless and until in good business judgment it shifts from being a mere possibility to more of a probability. Concerning this rule, CAO has stated, "From the accounting perspective, an important concern is whether the contingent liability should be reflected in financial statements. In this context, the question is whether a given situation is sufficiently probable to justify recognition or is little more than a mere possibility."¹⁶

The GAO Policy and Procedures Manual for Guidance of Federal Agencies provides in this regard:

An estimated loss from contingency shall be accrued as an expense if both of the following conditions are met:

1. Information available prior to issuance of the financial statements indicates that it is probable that...a liability has been incurred...

2. The amount of loss can be reasonably estimated.¹⁷

On the other hand, if there is only the mere possibility of a liability being incurred, good accounting practice does not reflect a liability on the balance sheet.¹⁸

However, applied to the Anti-Deficiency Act, this accounting practice doesn't answer the question, "What if the contingency occurs and there is not enough in the appropriation to pay for the loss?" GAO may have agreed with the appropriate accounting action of not setting up a "mere possibility" as a liability. But, in legal terms, its rule that "contingent liabilities are illegal" is based on the fact that there may not be enough money in the relevant appropriation to pay the cost of the liability. In the case of the FAA aircraft lease, even though the maximum liability was measurable, without a contingency reserve there was no guarantee that the appropriation would contain even that measured amount in the event the contingency should occur. Thus FAA's attempt to distinguish its situation, involving a fixed amount maximum liability, from one in which the maximum liability was indeterminate, did not really get to the heart of the matter.

It is possible that without a reservation of funds sufficient to cover the maximum extent of the Government's liability, that there could be a deficiency in the appropriation, thereby causing an

Anti-Deficiency Act violation. Also, without a reservation sufficient to cover the maximum potential liability of the Government, there is no way to know with certainty whether or not there would be enough money in the appropriation to pay all possible liabilities. These are the very objections to obligating the Government for indeterminate contingent liabilities. There could be situations in which the appropriation could be deficient whether the potential liability was fixed or not. This would result in an Anti-Deficiency Act violation. Thus, for legal purposes of the Anti-Deficiency Act, 54 Comp. Gen. 824 "overruled" 42 Comp. Gen. 708 in that regard.¹⁹

2. The Legal Requirement and "Good Business Sense."

The administrative reservation of funds would seem to answer the objection to the limitation of liability approach that it may be a "naked promise." If the funds were reserved, the contractor could not complain that his benefits were or could be illusory. In fact, the Public Contracts Law Section suggested that faced with the limitation of liability provision, contractors may seek assurances that funds have been reserved:

A practical effect of the May 3, 1982 decision can be that contractors will insist the contracting agencies obtain and obligate appropriated funds to cover their commitment to reimburse contractor costs for third party claims...

The result can be that agencies will find it necessary to substantially increase their annual appropriation requests and maintain large reserves to cover contingencies that never happen.²⁰

In fact on at least three occasions, not involving indemnity, where, prompted by the Anti-Deficiency Act, the executive department created administrative reservations of funds for such contingencies,

Congressional committees instructed the agencies not to fund such reserves, and Congress itself declined to fund the reserves in the relevant appropriation bill.²¹ It just doesn't make sense to appropriate and set aside money the Government hopes never to have to spend.

4. The Legal Requirement and "Pooling."

Finally, the administrative reservation of funds presents the question of whether or not, in setting up such funds, the Government may "pool" its obligations. Pooling is the practice of grouping several potential liabilities together within a single account that would be looked to for payment in the event any of the liabilities should become due and owing. Here again, there may be a conflict between good business and accounting practice and the requirements of the Anti-Deficiency Act. In 34 Comp. Gen. 418 (1955), the Comptroller General commented upon proposed accounting regulations providing the prerequisites to the recording and reporting of certain obligations. Regarding certain contingent liabilities GAO said:

Subsection (b) provides that under fixed-price contracts with escalation, price redetermination, or incentive provisions, obligations shall be recorded for the amount of the fixed-price stated in the contract, or the target or billing price in the case of a contract with an incentive clause, and that the amount so recorded shall be increased or decreased to reflect price revisions at the time that such revisions are made or determined pursuant to provisions of the contract....While we have no objection to the recording of obligations upon that basis, such practice might well result in a violation of [the Anti-Deficiency Act], unless appropriate safeguards are provided either in this proposed Directive or in the administrative regulations issued under the latter act with the concurrence of the Director of the Bureau of the Budget. Such safeguards normally would consist of administrative reservations of sufficient funds to

cover at least the excess of the estimated increases over the decreases. (Emphasis added.)²²

This would indicate that the agency could "pool" its expected increases and its expected decreases, and administratively reserve only the difference between the two. This, again, is the rule of business and accounting. It is based upon estimates, probabilities.

However, the subsequent case of 54 Comp. Gen. 824 indicates that it is not the probability of a deficiency, but the possibility of one which is the violation of the Act.²³ The requirement for an administrative reservation of funds whenever there is the possibility of a deficiency indicates that there must be an administrative reservation of funds equal to the maximum possible Government liability, not just to the estimated increases minus decreases.

The regulations, however, continue to follow the rule of 34 Comp. Gen. 418. For example, the Department of Defense Accounting Manual, DOD 7220.9-M provides:

Amounts to cover...contingent liabilities should be carried as outstanding commitments [i.e., "administrative reservations of funds"] pending determination of actual obligations. However, the amounts of such contingent liabilities need not be recorded at the maximum or ceiling prices under the contracts. Rather, amounts conservatively estimated to be sufficient to cover the additional obligations which will probably materialize, based upon judgment and experience should be committed [i.e., "reserved"]. In determining the amount to be committed allowances may be made for the possibilities of downward price revisions and quantity underruns.²⁴

The regulation goes on to approve of the practice of "pooling" the difference between expected increases minus decreases over several contracts. It states, "For purposes of estimating and recording, these

contingent liabilities may be grouped together under one financial authority as a single commitment item, or subsidiary account, rather than under each individual outstanding contract."²⁵ The regulation, therefore, allows for the possibility of an Anti-Deficiency Act violation. 54 Comp. Gen. 824 proscribes the situation in which the funding status of a contract allows for the possibility of a deficiency. Therefore, it would seem that regulations allowing for such a possibility fail to meet the requirements of the law. Once again this seems to evidence a conflict between good business and accounting practice and the requirements of the Anti-Deficiency Act. It also demonstrates one instance in which a contracting officer following all the regulations could still violate the prohibition against making an obligation in excess of appropriations, and possibly create an actual deficiency in the appropriation account.

The predecessor to DoD 7220.9-N, DoD 7220.9-H, Accounting Guidance Handbook, February 1, 1978, acknowledged this:

Overobligations and Overexpenditures Resulting from Inaccurate Estimates of Obligations and Inadequate Reservations of Funds to Cover Contingent Liabilities. The law prohibits obligations of appropriations and other funds in excess of the actual legal liability of the Government at any given time. In the case of some indefinite price contracts and similar obligations, it is difficult to determine the precise amount of the Government's liability at the time contracts are made, and it is considerably more difficult to determine the Government's ultimate legal liability under such contracts. In these cases the allottee is responsible for reserving funds to cover the Government's potential or contingent liability under the contract in excess of that amount which may be recorded as a valid obligation...to ensure that sufficient funds are available to cover net increases in obligations if such contingent liabilities become legal liabilities of the Government. While it is recognized that these cases present many difficulties from a control standpoint,

the allottee, nevertheless, is responsible for ensuring that only valid obligations are recorded against his allotment and that sufficient funds are available in his allotment to cover all increases in such obligations. If the allotment becomes overobligated or overexpended because of inaccurate estimates of obligations or failure to reserve sufficient funds to cover contingencies, a violation of ²⁶[the Anti-Deficiency Act] has occurred.

From this it would appear that the responsible individual is forced to play a game of chance with a criminal statute. If he estimates correctly, no violation occurs. If he does not, a violation has occurred. If he reserves too much, that money may not be put to good use.

C.

EXPRESS STATUTORY AUTHORITY

1. Indemnity Statutes.

a. The Indemnity Statutes Concerned.

In the context of contingent liabilities, express statutory authority is specific authority enacted by Congress for the Government to enter into given contingent liability obligations. There are currently five areas in which this has been done involving indemnity. They are: 1) 10 U.S.C. § 2354, allowing indemnity provisions in DOD research and development contracts (42 U.S.C. § 241(a)(7) extends this authority to the Secretary of Health and Human Services for research contracts of that agency); 2) 38 U.S.C. § 4101(c)(3)(A), allowing indemnity provisions in Veteran's Administration medical research contracts; 3) 42 U.S.C. § 2210, allowing indemnity provisions in the licensing of nuclear reactors by the Atomic Energy Commission; 4) 42 U.S.C. § 2458b(b), which allows indemnification against third party claims for the user of a NASA space vehicle; and, 5) 50 U.S.C.

§ 1431, commonly referred to by its public law designation, P.L. 85-804, which gives the President broad authority to enter into or modify contracts of agencies exercising national defense functions "without regard to other provisions of law relating to the making, performance, amendment, or modification of contracts whenever he deems that such action would facilitate the national defense."²⁷

b. Express Statutory Authority and Funding.

As each statute is considered individually, it is necessary once again to remember that what is important is not only the authority to enter into such an obligation, but also the source of funding for each obligation entered into pursuant to that authority. There must be either an appropriation of funds to pay for the obligation, or "contract authority." Contract authority has been defined earlier in this paper by its definition as given in O.D. Circular A-34 as "statutory authority under which contracts or other obligations may be entered into prior to an appropriation (liquidating cash) for the payment of such obligations."²⁸

c. The Individual Statutes and Their Respective Sources of Funding.

Each of these statutes will state in its own terms 1) the risks which the Government may assume pursuant to it, and 2) the source of funding for payment of any obligations arising on account of the risks assumed. This is done to highlight the comparisons and contrasts in the way these matters are handled in the various statutes.

(1). 10 U.S.C. § 2354:

(a) Any contract of a military department for research or development, or both, may provide that the United States will indemnify the contractor against either or both of the following, but only to the extent that they

arise out of the direct performance of the contract and to the extent not compensated by insurance or otherwise:

(1) Claims...by third persons, including employees of the contractor, for death, bodily injury, or loss of or damage to property, from a risk that the contract defines as unusually hazardous.

(2) Loss of damage to property of the contractor from a risk that the contract defines as unusually hazardous.

....

(d)...payments...may be made from--

(1) funds obligated for the performance of the contract concerned;

(2) funds available for research or development, or both, and not otherwise obligated; or

(3) funds appropriated for those payments.

(2). 38 U.S.C. § 4101(c)(3):

(A) With the approval of the Administrator, any contract or research authorized by this section, the performance of which involves a risk of an unusually hazardous nature, may provide that the United States will indemnify the contractor against either or both of the following but only to the extent that they arise out of the direct performance of the contract and to the extent not covered by [insurance, including any self-insurance plan].

(i) Liability...to third persons...from a risk that the contract defines as unusually hazardous.

(ii) Loss of or damage to property of the contractor from a risk that the contract defines as unusually hazardous.

....

(D)...payments...may be made from--

(i) funds obligated for the performance of the contract concerned;

(ii) funds available for research or development or both, and not otherwise obligated; or

(iii) funds appropriated for those payments.

(3). 42 U.S.C. § 2210:

(c) The Commission shall, with respect to licenses issued between August 30, 1954, and August 1, 1977, for which it requires financial protection, agree to indemnify and hold harmless the licensee and other persons indemnified, as their interest may appear, from public liability arising from nuclear incidents which is in excess of the level of financial protection required of the licensee.

....

(j) In administering the provisions of this section, the Commission may make contracts in advance of appropriations and incur obligations without regard to [the Anti-Deficiency Act].

(4). 42 U.S.C. § 2458b:

(b) Indemnification

Under such regulations in conformity with this section as the [NASA] Administrator shall prescribe taking into account the availability, cost and terms of liability insurance, any agreement between [NASA] and a user of a space vehicle may provide that the United States will indemnify the user against claims...by third parties for death, bodily injury, or loss of or damage to property resulting from activities carried on in connection with the launch, operations or recovery of the space vehicle, but only to the extent that such claims are not compensated by liability insurance of the user: Provided, That such indemnification may be limited to claims resulting from other than the actual negligence or willful misconduct of the user.

....

(e) Payments

[P]ayments...may be made, at the Administrator's election, either from funds available for research and development not otherwise obligated or from funds appropriated for such payments.

(5). 50 U.S.C. § 1431:

The President may authorize any department or agency of the Government which exercises functions in connection with the national defense...to enter into contracts or into amendments or modifications of contracts...without

regard to other provisions of law relating to the making, performance, amendment, or modification of contracts, whenever he deems that such action would facilitate the national defense....

Pursuant to this statute several executive orders implementing it have been issued.²⁹ The most recent is Executive Order No. 12148 of July 20, 1979. This order provides in relevant part:

[Without regard to amounts appropriated or the contract authorization provided therefor, the Government may enter into contracts providing] that the United States will hold harmless and indemnify the contractor against [third party claims; loss of, damage to, or loss of use of contractor property; loss of, damage to, or loss of use of property of the Government; claims arising from indemnification agreements between the contractor and subcontractors or between subcontractors], whether resulting from the negligence or wrongful act or omission of the contractor....This exception...shall apply only to claims or losses arising out of or resulting from risks that the contract defines to be unusually hazardous or nuclear in nature.³⁰

d. The Relationship of Express Statutory Authority to Contract Authority.

There, in summary, is the express statutory authority and "payment authority" pursuant to which indemnity provisions may be included in contracts. 42 U.S.C. § 2210 specifically states that it is to function without regard to the Anti-Deficiency Act. Likewise, 50 U.S.C. § 1431 operates "without regard to other provisions of law relating to the making...of contracts." On the other hand, 10 U.S.C. § 2354 and 38 U.S.C. § 4101 do not state that they operate "without regard to" other laws relating to Government contracting. But, in their respective payment sections they provide implicitly that the indemnity provisions they allow may be made "in advance of appropriations." They authorize

payment from 1) contract funds, 2) unobligated money of the appropriation, or 3) funds appropriated for those payments. Note that those statutes themselves do not appropriate funds for those payments. Currently there are no funds appropriated specifically for indemnity payments. Congress however, is "inviting" requests for such payments.

42 U.S.C. § 2458b is even more definite in this regard. It provides that payments pursuant to its authorized indemnity provisions shall be made at the Administrator's election either from 1) funds available for research and development not otherwise obligated, or 2) from funds appropriated for such payments. The legislative history of this Act indicates that Congress expects to be asked for special appropriations on account of the indemnity provisions. It states, "A decision on whether to use existing appropriations or seek additional appropriations from Congress specifically to pay meritorious claims rests with the Administrator. It is the intent of this subsection that no authorized NASA program should be curtailed or terminated because of such indemnification payments."³¹ Unless there is "extra" money in the appropriation not dedicated to any other "authorized NASA program," Congress may expect the operation of any indemnity provision pursuant to this statute to generate a request for a special appropriation.

Thus, in these latter three instances, it appears that what Congress has done is neither to have given "contract authority" (in the "without regard to an appropriation therefor" sense), nor to have made appropriations for the obligation. It has rather implicitly vouched to make an appropriation if need be. Nevertheless, no one has seriously challenged the proposition that any of these statutes do in fact

provide the agencies with authority to enter into such agreements. Nor has anyone suggested that in these instances either a limitation of liability or an administrative reservation of funds is required. Indeed, 10 U.S.C. § 2354 and 38 U.S.C. § 4101 are among the instances of express statutory authority that GAO used as examples of statutory authority that would render the limitation of liability or reservation of funds unnecessary.³²

e. The Relationship of Express Statutory Authority to Insurance.

In this discussion it has been the statutory authority and payment provisions of the statutes which have been most important. However, there are two other features common to all of these various authorities. The first is that the authority granted in each of them is limited to allow indemnification only for risks which are unusually hazardous or nuclear. The second is that the exercise of that authority bears some relationship to insurance. These two features are themselves related. This relationship is highlighted by the most recent of these statutes, 42 U.S.C. § 2458b. In exercising its discretion to obligate the United States to an indemnity provision, NASA is to take into account "the availability, cost, and terms of liability insurance."³³ This would indicate that NASA is to make business judgment as to whether or not it is economically reasonable or practical to insure against a given risk with commercial insurance. If insurance is available at a reasonable price and on reasonable terms, that may be the preferred course of action. On the other hand, if the cost is prohibitive, the Government may decide to assume the risk itself.

There is nothing in the statutes themselves or in any regulations issued pursuant to them which helps to define "unusually hazardous." But, in each statute, indemnification is presented as an alternative to insurance or other "financial responsibility" measure. This may be some indication that "unusually hazardous" may be construed to mean a risk, the potential liability from which is in excess of reasonable insurance coverage. In other words, the reasonableness or unreasonableness of commercial insurance coverage (or other cost of having the contractor assume the risk in question) would be the sole criterion for determining whether or not the risk was "unusually hazardous."

Furthermore, the legislative history to 50 U.S.C. § 1431 (P.L. 85-804) indicates:

One of the most significant developments under title II has been use of that authority as a basis for indemnity provisions in certain contracts. Based on the broad language of that act, the authority would be continued under this bill. The need for indemnity clauses in most cases is a direct outgrowth of military employment of nuclear power and the highly volatile fuels required in the missile program. Because of the magnitude of the risks involved, commercial insurance policies are either unavailable or provide insufficient coverage. Testimony before a subcommittee of the House Judiciary Committee by representatives of the military departments indicated that contractors were therefore reluctant to enter into contracts involving the risk of a catastrophe without an indemnification provision.

Although the military departments have specific statutory authority to indemnify contractors engaged in research and development, this authority does not extend to production contracts (10 U.S.C. 2354). Nevertheless, production contracts for items like nuclear-powered submarines and missiles, although not considered especially hazardous, still give rise to the possibility of an enormous amount of claims. The Department of Defense and the committee believe, therefore, that to the extent that commercial insurance is unavailable, the risk of loss should be borne by the United States. Similar authority was granted to the Atomic Energy Commission by Congress last year in the

Price-Anderson Act (Public Law 85-177) [42 U.S.C. § 2210]. (Emphasis added.)³⁴

Three agencies have addressed this issue. The FAA and NASA have taken the position that the commercially reasonable availability of insurance is the criterion for determining whether or not a certain risk is or is not unusually hazardous.³⁵ On the other hand, the Air Force has not chosen to adopt such a position.³⁶ All of this once again illustrates that these risks are directly related to or result from the performance of the contracts in question.

Therefore, the costs associated with these risks, however allocated or assumed, certainly ought to be considered "necessary expenses" for purposes of the rule of that name described in Chapter III. In other words, this relationship strengthens the argument that there is no basis for the GAO's determination that an agency has no authority to indemnify contractors for risks associated with the contract when those risks are pricing factors of the contract. The relationship of the cost of insuring against these risks to direct indemnification indicates that the risks are valid pricing considerations. This argues against any determination that an agency lacks authority to deal with contingent contract risks, such as GAO made in B-137976. GAO's objections ought not to be with regard to the authority, as such, to allocate these contractual risks, but to the lack of an appropriation adequate to fund them. Conversely, Congressional involvement in providing authority to enter into such indemnity agreements as it has allowed by specific statute may indicate to the agencies that absent such authorization, Congress does not envision that the appropriations

made are adequate to assume such risks.

f. Answers in Pending Legislation.

The "Contractor Liability and Indemnification Act,"³⁷ presently pending before Congress, evidences that lessons have been learned from the wording and operation of the present statutes discussed above. The Act in both its House and Senate versions provides in relevant part:

The United States shall include in any contract hereafter made, and may include by amendment or modification in any contract heretofore made, a provision that the United States will hold harmless and indemnify the contractor against any of the claims or losses set forth in subsection (b) [i.e., third party claims, loss of or damage to contractor property, loss of or damage to Government property, and approved indemnifications with subcontractors], whether resulting from the negligence or wrongful act or omission of the contractor or otherwise, except as provided in subsection (b)(2): Provided, That such provision shall apply only to claims for losses arising out of or resulting from risks that the contract defines as (1) unusually hazardous or nuclear in nature or (2) giving rise to the possibility of liability against which the contractor cannot reasonably protect through private insurance or self-insurance...A contractual provision for indemnification may require each contractor so indemnified to provide and maintain financial protection of such type and in such amount as is determined by the head of the contracting agency or his designee to be appropriate under the circumstances. In determining whether conditions for the use of an indemnification provision have been met, and in determining the amount of financial protection to be provided and maintained by the indemnified contractor, the appropriate official shall take into account such factors as the availability, cost, and terms of private insurance, self-insurance, other proof of financial responsibility, and worker compensation insurance.³⁸

Regarding payment, the House and Senate versions of the bill are substantially the same.³⁹ The House version of the bill provides:

Notwithstanding the provision of sections 1341, 1349 through 1351, and 1512 through 1519 of title 31, United States Code [the Anti-Deficiency Act], or section 3732 of the Revised Statutes of the United States (41 U.S.C. 11) [the Adequacy of Appropriations Act], each contracting agency is authorized to make payments pursuant to any indemnification provisions included in contracts under subsection (a) of this section from (A) funds obligated for the performance of the contract from which the contractor's liability arises; (B) funds which are available to the agency for the same type of contract as the contract from which the contractor's liability arises, and which are not otherwise obligated; (C) funds specifically appropriated for such payments; and (D) funds appropriated pursuant to section 1304 of title 31 United States Code.⁴⁰

Thus, this Act would make it clear that Congress only intends to indemnify when commercial insurance or other private means of financial protection is not reasonably available, but that the agencies are free to indemnify whenever other insurance is not reasonably available. The Act also makes it clear that such obligations as it allows may be made "notwithstanding" the Anti-Deficiency Act and the Adequacy of Appropriations Act. It would appear that the drafters of the pending bill appreciate the questions raised by the present statutes. This legislation would also eliminate from consideration any question about "necessary expense." All contractor property and third party claim indemnity provisions would be based upon "express statutory authority."

This legislation at least implicitly recognizes that the risks involved are valid pricing considerations, which for the most part are most prudently handled through commercial insurance. It also removes all doubt as to the legal questions surrounding the use of indemnity clauses and makes clear the policy for their use. On these accounts it is to be lauded.

g. Summary.

This section has reviewed the currently enacted "express statutory authority" whereby the Government may obligate itself for contingent liability indemnity agreements. It has also outlined the funding schemes for this authority. A previous section has already discussed that the implications of these sections may be that without such express statutory authority and concomitant designated funding source, the Government may be without authority to enter into such agreements.⁴¹ The relationship of this authority to the "necessary expense" rule has also previously been discussed.⁴² A subsequent section will consider the manner in which the Government has dealt with nonstatutory indemnification situations as a practical matter.⁴³

2. "Cancellation" or "Termination" of DOD Multiyear Contracts.

There is one other area where a contingent liability has been statutorily recognized, and approved of by Congress. That area is Department of Defense "multiyear" contracting. "Multiyear contracting" refers to contracts extending over a period of more than one year and up to five years.⁴⁴

The statute authorizing multiyear contracting is codified at 10 U.S.C. § 2306 (g) and (h). Its legislative history briefly describes the concept as follows:

Multiyear contracting is a procurement method used to purchase known requirements of military supplies and services in quantities and total costs, even though the total funds ultimately to be obligated by the contract are not available. Award is made on the multiyear basis, funds are obligated only for the first year's quantity, with succeeding years' contract quantities funded annually thereafter. If funds are not available for the succeeding years, the contract is cancelled.⁴⁵

The contingent liability recognized by this statute is "cancellation" or "termination" liability. It is not truly a contingent liability in the same sense as the indemnity statutes above named. A contingent liability was earlier defined to be one which was not now fixed and absolute, but would become so upon the happening of some future and uncertain event.⁴⁶ Usually the event in question would be thought to be something outside the control of either party to the contract. But, the event contemplated here is completely within the discretion of the Government. It is the contingency that Congress should choose not to continue to fund a program being procured on a "multiyear" basis. In that event, a "cancellation" or "termination" liability would accrue to the Government. The liability is contingent upon terminating the contract. But, the Government has the option of continuing to fund the program. In the sense that the Government must choose one of two options, either to continue the program or terminate, the liability may be considered a contingent liability. The contingent liability assumed by the Government in such contracting is the liability that would accrue to it in the event the contract is "cancelled" prior to the time originally contemplated and contractually agreed upon by the parties.

a. The Statute Concerned.

Once again, The statute will speak for itself regarding the authority it provides to assume unfunded contingent obligations. Subsection (g) deals with services and subsection (h) deals with property. Subsection (g) provides:

(g)(1) the head of an agency may enter into contracts for periods of not more than five years for the following types of services (and items of supply related to such services for which funds would otherwise be available for obligation only within the fiscal year for which appropriated--

(A) operation, maintenance, and support of facilities and installations;

(B) maintenance or modification of aircraft, ships, vehicles, and other highly complex military equipment;

(C) specialized training necessitating high quality instructor skills (for example, pilot and other aircrew members; foreign language training); and

(D) base services (for example, ground maintenance; in-plane refueling; bus transportation; refuse collection and disposal);

And subsection (h) provides:

To the extent that funds are otherwise available for obligation, the head of an agency may make multiyear contracts...for the purchase of property, including weapon systems and items and services associated with weapon systems (or the logistics support thereof), whenever he finds--

(A) that the use of such contract will promote the national security of the United States and will result in reduced total costs under the contract;

(B) that the minimum need for the property to be purchased is expected to remain substantially unchanged during the contemplated contract period in terms of production rate, procurement rate, and total quantities;

(C) that there is a reasonable expectation that throughout the contemplated contract period the Department of Defense will request funding for the contract at the level required to avoid contract cancellation;

(D) that there is a stable design for the property to be acquired and that the technical risks associated with such property are not excessive; and

(E) that the estimates of both the cost of the

contract and the anticipated cost avoidance through the use of a multiyear contract are realistic.

It should be noted that the contingent obligation here at issue is more subtle than those allowed in any of the indemnity statutes. There Congress was dealing with a pure matter of risk allocation, a pricing factor. The risks were those of loss of or damage to contractor property and third party claims. Here, "to the extent that funds are otherwise available for obligation," the Government is authorized to enter into contracts not funded to completion over the multiyear term. The risk in question is the risk that Congress would choose not to provide the funds necessary to see the contract through to completion, and the contract would have to be "cancelled" or "terminated." While this is certainly a pricing consideration (in fact, multiyear is only authorized when it is determined that its use "will result in reduced total costs under the contract;"⁴⁷), it is not a matter of allocating a particular expense of the contract to one party or the other. It is the contract itself whose life is at issue. The question is, "If the Government chooses to contract so as to get the benefits of "reduced total costs" from a long term contract or quantity buy, how will it handle the situation in the event a subsequent Congress chooses not to fund that contract so priced?" It is a risk which is necessarily the Government's if the Government is to get the pricing advantage sought by multiyear procurement.

The statute recognizes this in the following language:

(2)(A) The Secretary of Defense shall prescribe defense acquisition regulations to promote the use of multiyear contracting as authorized by paragraph (1) in a manner that will allow the most efficient use of

multiyear contracting.

(B) Such regulations may provide for cancellation provisions in such multiyear contracts to the extent that such provisions are necessary and in the best interests of the United States. Such cancellation provisions may include consideration of both recurring and nonrecurring costs of the contractor associated with the production of the items to be delivered under the contract.⁴⁸

Thus, the statute recognizes that there may be both recurring and nonrecurring contractor costs which may be a part of the price of cancelling a multiyear contract before its term. These costs will be further discussed in Chapter V.D.1.a..

b. The Payment Provisions.

Congress has allowed the Department of Defense to recognize the above described costs and has provided that funds for payment in the event of contract "cancellation" or "termination" may come from the following sources:

In the event funds are not made available for the continuation of a contract made under this subsection into a subsequent fiscal year, the contract shall be canceled or terminated, and the costs of cancellation or termination may be paid from--

(A) appropriations originally available for the performance of the contract concerned;

(B) appropriations currently available for procurement of the type of property concerned, and not otherwise obligated; or

(C) funds appropriated for those payments.⁴⁹

Thus, many of the same questions that surround the indemnity statutes are presented by the language of this one as well. No money is currently appropriated for cancellation payments by this statute.

Therefore, assuming original appropriations for performance of the contract concerned and current appropriations for procurement of the type of property concerned are exhausted or not otherwise "available," Congress again appears to be "inviting" requests for deficiency appropriations. This issue will be further discussed in the section on termination issues.⁵⁰

3. The Relationship of Express Statutory Authority to "New Spending Authority."

It should be noted almost as a matter of curiosity that with such a scheme as has been provided for by all the above payment provisions, Congress may have transgressed one of its own rules. 2 U.S.C. § 651(a) provides:

It shall not be in order in either the House of Representatives or the Senate to consider any bill or resolution which provides new spending authority described in subsection (c)(2)(A)...of this section (or any amendment which provides such new spending authority), unless that bill, resolution, or amendment also provides that such new spending authority is to be effective for any fiscal year only to such extent or in such amounts as are provided in appropriation Acts.

Subsection (c)(2)(A) defines "new spending authority" to include authority "to enter into contracts under which the United States is obligated to make outlays, the budget authority for which is not provided in advance by appropriation Acts." (Emphasis added.)

OMB Circular A-34 gives the definition of "budget authority":

Budget authority--Budget authority for any year represents the authority provided by law and becoming available during the year to incur obligations. The basic forms of "budget authority" are the following:
Appropriation--Statutory authority that allows Federal agencies to incur obligations and to make payment out of the Treasury for specified purposes.

This is the most common form of budget authority....

....

Contract authority....⁵¹

Thus, Congress has effectively eliminated "contract authority," the authority to incur obligations in advance of appropriations,⁵² from the definition of "new spending authority." Congress has made a rule for itself requiring all new spending authority to be supported by advance appropriations. This narrows considerably the use of "budget authority" insofar as it had included "contract authority."

While the Act appears to be prospective only, subsection (f) requires Congress to study on a continuing basis those provisions of law, in effect on the effective date of the Act, which provide spending authority or permanent budget authority.⁵³ This is to be done with a view toward terminating or modifying those provisions.⁵⁴

In cases such as the above indemnity and multiyear statutes, which provide express statutory authority to assume contingent liabilities without an advance appropriation, the practical effect of the limitation on the use of contract authority is probably nothing more than that Congress has chosen not to follow its own rule.

D.

THE "NECESSITY EXCEPTION"

The first two sections of this chapter considered two nonstatutory means of obligating the Government for contingent liabilities. They are limitation of liability and reservation of funds. The third section dealt with statutorily provided means for so obligating the Government. This section turns to yet another GAO approved situation in which the Government may obligate itself for contingent liabilities. This is not a means of complying with the Act, as limitation of liability and reservation of funds purport to be, or a statutorily recognized exception to the Act, as the statutes cited in section C. above are. But, it is an "exception" to the Act, nonetheless. The reason for placing it by itself at the end is that it is of virtually no importance as precedent for other situations. GAO has wisely limited it strictly to the facts of the situation in which it was allowed.⁵⁵ Furthermore, while purporting to be an indemnity situation, and so handled by GAO, it really does not present an indemnity situation in fact.

1. The Exception Recognized.

In 59 Comp. Gen. 705 (1980) the Acting Administrator of the General Services Administration (GSA) petitioned GAO about the legality of certain indemnity provisions under tariffs by which GSA had been for some time and presently was procuring electricity. The indemnity provisions were "non-negotiable" by the utility companies. GSA put forth the following as a "typical indemnification provision":

Customer assumes all responsibility for the electric power and energy delivered hereunder after it leaves

company's lines at the point of delivery, as well as for the wires, apparatus and appurtenances used in connection therewith where located at or beyond the point of delivery; and Customer hereby agrees to protect and save Company harmless and indemnified from injury or damage to persons and property occasioned by such power and energy or by such wires, apparatus and appurtenances located at and beyond said point of delivery, except where said injury or damage shall be shown to have been occasioned by the negligence of Company or its contractors. Further, Company shall not be responsible for injury or damage to anyone resulting from the acts of the employees of Customer or of Customer's contractors in tampering with or attempting to repair and/or maintain any of Company's lines, wires, apparatus or equipment located on Company's side of the point of delivery; and Customer will protect, save harmless and indemnify Company against all liability, loss, cost, damage and expense, by reason of such injury or damage to such employee or to any other person or persons, resulting from such acts of Customer's employees or contractor.⁵⁶

The Acting Administrator was concerned about the clause on the basis of the Anti-Deficiency Act. GAO allowed the purchase of electricity with the clause stating:

The problem [of obligating the Government to indemnify the utility in violation of the Anti-Deficiency Act] cannot be resolved without new legislation if we adopt an overly technical and literal reading of the Anti-Deficiency Act in this situation. We do not think such a reading is appropriate under these circumstances. GSA is authorized to procure utility services for the Government and to do so under utilities' tariffs....As noted already, this [inclusion of the indemnity provision] has of necessity been the practice in the past....However, because the possibility exists, however remote, that these agreements could result in future liability in excess of available appropriations,⁵⁷ GSA should inform the Congress of the situation.

2. The Exception Limited.

In the above case GAO admitted that the consistency it had so long touted was being ignored in the name of necessity. However, in B-197583, Jan 19, 1981, the Comptroller General made it clear that the "exception" it had created was narrow and based on a rule of absolute necessity. In that case, the Architect of the Capitol also questioned the legality of an indemnity clause which the utility said was required by District of Columbia Public Service Commission regulations. The clause was being insisted upon by the electric company in a contract to perform tests on certain electrical equipment. It was substantially similar to the one above quoted in that it "absolved" the utility of all liability absent its negligence. In disapproving of its use GAO said:

[U]nlike the GSA case, here there is another source for performing the test, that is, the Government employees who in fact have performed the tests in the past. An even more important distinction, though, is that unlike the situation in the GSA case, the Architect has not previously been accepting the testing services or using the impulse device from Pepco [the utility] and has therefore not previously agreed to the liability represented by the proposed indemnity agreements. In the GSA case, GSA merely sought to enter a contract accepting the service and attendant liability, previously secured under a non-negotiable tariff, at a rate more advantageous to the Government. Here, however, the Government has other means available to provide the testing and monitoring desired.⁵⁸

3. The Exception Analyzed.

It is both sad and curious that GAO analyzed and decided these matters this way. Obviously, there is no statutory citation to the "necessity exception" to the Anti-Deficiency Act. In fact, where exceptions have been dictated by necessity, Congress has provided the legal authorization. For example, the Adequacy of Appropriations Act, 41 U.S.C. § 11 authorizes an exception by which the Armed Services may contract for the means of subsistence without benefit of current appropriations.⁵⁹

Moreover, GAO subsequently took the position that all indemnity provisions ought to be based upon express statutory authority.⁶⁰ In the same opinion where it did that, it defended the "necessity exception" case.⁶¹

But, what is more curious is that, while from 20 Comp. Gen. 632 until 54 Comp. Gen. 824 GAO consistently ignored to varying degrees the logic of the Anti-Deficiency Act, here it made the Anti-Deficiency Act an issue when it did not have to do so. In the past, the Anti-Deficiency Act should have been called upon and wasn't; here, it was invoked and didn't have to be. In fact, it should not have been an issue. GAO could have realized that it was not dealing with an indemnification provision as such. All the clause says is what the law says anyhow: that the utility will not be held liable absent its negligence.⁶² There is no theory other than negligence upon which liability could accrue to the utility.⁶³ Therefore, the import of the clause is no more than that the utility is making clear that it will not be liable just because it is providing service or, as in the

case of the Architect of the Capitol, performing the tests.

All this is very disconcerting regarding the extent to which form seems to control over substance in this series of GAO opinions. In the earlier ones which were not addressed to the GAO in the context of the Anti-Deficiency Act, the Act seems to have been ignored. In these later two cases that involve clauses which use the word "indemnity," the Anti-Deficiency Act is automatically seen as an obstacle. GAO "analyzed" the situation in 59 Comp. Gen. 705 to the effect that, "The possibility of liability under this clause is in our judgment remote."⁶⁴ In point of fact, they could not have analyzed the situation at all except to surmise that factually the possibility of an accident may be rather remote. However, it is not the fact of an accident itself by which the utility company may be held liable. In the law, it is only on the basis of negligence that liability accrues to a public utility. And, the clause does not ask the Government (customer) to assume liability for the utility's negligence. Indeed, it is inconceivable that any public utility commission would allow an electric company (or other utility) to contract out of its own negligence in any event. In law, under the clause the possibility of Government liability for the utility's tort is not remote, it is not possible at all. Once again, the clause is merely descriptive of what the law says about the liabilities of the seller and buyer of electricity.

4. The Utility of the Exception.

It is true irony that GAO reluctantly created its own "necessity" exception to the Anti-Deficiency Act in a situation that did not even present an Anti-Deficiency Act problem. GAO is to be criticized both for its shallow non-legal analysis of the situation, but also (even assuming the correctness of its factual analysis) for opening the dike it had built over forty years regarding the import of the Anti-Deficiency Act. The rule of necessity has no statutory basis, and necessity itself takes on subjective characteristics. An agency's idea of "necessary" may not square with GAO's, especially where, as in the case of the Architect of the Capitol, GAO felt free to present its own alternatives to the necessary action.⁶⁵ GAO could conceivably also require the alternative of "doing without" the necessity, and in all events the Comptroller General prohibits the agency from making the best business judgment determination of how to accomplish its mission. If, as GAO correctly pointed out, only legislation could create an Anti-Deficiency Act exception, then legislation should have been sought.

GAO's opinion B-197583 for the Architect of the Capitol and its statement in 62 Comp. Gen. 361 that 59 Comp. Gen. 705 (the "necessity exception" case) was not to serve as precedent indicate its general unhappiness with the "narrow exception" it was "forced" to carve out there. Nevertheless, GAO did discuss the exception (though without suggesting any precedential value to it, or rules for its subsequent use) in its Principles of Federal Appropriations Law.⁶⁶

The Office of Federal Procurement Policy's task force on

Indemnification surveyed thirty-five agencies with nineteen responding about the need for Government indemnification of contractors. As a result of that survey, it did report on two instances where allegedly an agency had relied upon the necessity exception:

One agency indicated that it had in the past relied on the rule of necessity to indemnify its contractors, relying on a rule of necessity recognized by the Comptroller General in 59 Comp. Gen. 705 (1980). The agency agreed to indemnify an airline for evacuation flights from Viet Nam though the agency did not have express statutory authority to indemnify its contractors. This agency also used the rule of necessity in agreeing to indemnify certain sea carriers during the fall of Indo China for certain liabilities.⁶⁷

It is interesting to note that the agency used a rule which was recognized by the Comptroller General in 1980 to indemnify against risks arising from contracts for services involved in the evacuation of Viet Nam and the fall of Indo China, events which took place in the 1970s. Nevertheless, this indicates a recognition of such an exception by the Office of Federal Procurement Policy Task Force. In commenting on the usefulness of the exception, the Task Force said, "there is considerable uncertainty as to when...a determination [that a contract situation falls within the rule of necessity] can be made without violating the Anti-Deficiency Act."⁶⁸ Therefore, it appears that the Office of Federal Procurement Policy's Task Force and the agencies are no more satisfied with the exception than is GAO.

CONTINGENCIES IN FACT

With consistency a great soul has simply nothing to do....Speak what you think today in hard words and tomorrow speak in hard words again, though it contradict everything you said today.

-Emerson

Thus far this paper has considered the legal background applicable to Government contract contingent liabilities. This background has included the Anti-Deficiency Act, the authority for the Government to contract (either as such authority may be expressly stated statutorily or as a "necessary expense" to the purposes of some more general appropriation), and the recognized means whereby the Government may assume contingent liabilities. The paper has also attempted to present a picture of how these rules are understood or generally applied by the GAO, the courts, and the agencies themselves. That picture suggests that while the rule regarding contingent liabilities has been "consistently" stated over time, the application of the rule has been anything but consistent. It is in this context that the agencies have had to confront contingencies as a practical matter in contracting situations.

The emphasis turns now from the legal context within which the Government has developed rules and policies regarding contingent liabilities, and focuses on the factual situations which have most commonly presented themselves in contracting situations. There are several areas where the Government has been faced with contingent liabilities in allocating contractual risks. This chapter will first identify and describe the major areas where this has been done. It will

then set forth how the Government has chosen to deal with those contingencies contractually. Finally, it will attempt to assess the extent to which each of the Government's policies regarding the various risks in fact squares with the legal rules set forth previously.

If there is a question as to how the Government policies regarding certain contingencies could appear to be at odds with the legal rules, it should be kept in mind that both the law and the policy are dynamic. They have developed, evolved, and changed over time. Further, as has been pointed out above, the understanding of the law has not been clear cut or uniform throughout the Government. Policy may have been set in the context of an understanding of the law which was later changed. But, the policy may not have realized how it was impacted by the change in the understanding of the law.

The contingent liabilities to be considered include 1) indemnity, 2) contract clauses which vary the contract price (economic price adjustment clauses and incentive contracting), 3) changes, and 4) termination issues.

A.

INDEMNITY

The risk contemplated by indemnity is the risk of loss of or damage to contractor property and third party claims arising out of the performance of the contract.

Indemnification is an assurance wherein one party frees another from an anticipated loss, or risk of loss, or prevents him from suffering loss or damage due to the legal consequences of an act or forbearance on the part of one of the parties to a contract or some third person. A legislative act is called "indemnification" when it provides a procedure for the Government either to reimburse contractors for payments made in satisfaction of judgments rendered against them or to anticipate adverse judgments and assume the obligations to pay such judgments when rendered.

There has already been considerable discussion of indemnity in this paper. Indemnification issues have provided the subject of virtually all of the court and GAO opinions regarding contingent liabilities, and it is the most common subject of express statutory authority enacted for the Government to assume contingent obligations. The final chapters regarding both the GAO's opinion on nonstatutory indemnification (and its apparent difference of opinion with the FAR), and statutory indemnification have yet to be written. The GAO has taken the position that absent express statutory authority the Government should adopt a policy not to indemnify against contractor or third party losses.² There are pending in the Congress various bills on the subject.³ It is also the subject of a 1982 Office of Federal Procurement Policy (OFPP) Interagency Task Force on Indemnification Report.⁴

Basically, indemnification provisions break down along two lines: those entered into pursuant to specific statutes, and those without

benefit of "express statutory authority." This paper is limited in scope to considering the legal authority for assuming contingent obligations, as such authority is dependent upon both authorization and appropriation acts. The employment of "express statutory authority" for indemnification is necessarily dependent upon Congress. It is Congress that enacts statutes. Those statutes providing for indemnification and their payment provisions have been discussed in Chapter IV.C. The remainder of this section, therefore, will focus on nonstatutory areas where the Government has decided to act as indemnifier.

There is currently only one standard clause which, without benefit of a statute, clearly states a policy of the Government to indemnify contractors. It is FAR 52.228-7, Insurance--Liability to Third Persons, (APR 1984). The present clause has changed significantly from its predecessor clauses, FPR 1-7.204-5 and 1-7.404-9, and DAR 7-203.22 and 7-402.26. By the DAR and FPR clauses, the Government assumed certain contingent third party liabilities without any monetary limitation. The FAR clause limits the Government's exposure to available "appropriated funds at the time a contingency occurs."⁵

The clause deals with allocation of risk of loss in the event the contractor should become liable to third parties on account of activity arising out of performance of the contract. The clause is required for cost reimbursement type contracts. It provides that the contractor must purchase and maintain third party liability and other insurance (or maintain an approved self-insurance program) in such form, amounts, and for such periods of time and with such insurers as the contracting officer requires or approves.

It further provides that the Government will reimburse the contractor for an allocable portion of the reasonable cost of insurance required by the contracting officer, and "without regard to and as an exception to the 'Limitation of Cost' or 'Limitation of Funds' clause of the contract,"⁶ for liabilities to third parties for loss of or damage to property or for death or injury, provided that any such liability is one 1) not compensated by insurance, 2) arising out of performance of the contract, 3) represented by a final judgment or settlement approved by the contracting officer, 4) for which the contractor is not otherwise responsible under specified terms of the contract, 5) for which the contractor has not failed to insure as required, and 6) which does not result from willful misconduct on the part of the contractor's officers, directors, or managers. In short, the Government assumes the risk of virtually all third party claims arising out of performance of the contract for which it has not required insurance (for which it would pay as an allowable cost).

The offensive part of the clause prior to the FAR change was the phrase "without regard to and as an exception to the 'Limitation of Cost' or 'Limitation of Funds' clause." In cost contracting the Government basically agrees to pay the contractor's costs of performing the work (subject to the rules of allocability and allowability⁷). An estimated cost is negotiated and that amount (or some part of it in the case of incrementally funded contracts⁸) is set forth in the contract schedule. By the Limitation of Cost⁹ or Limitation of Funds¹⁰ clauses, the Government obligates itself to pay the contractor only so much as has been set forth in the schedule. FAR

32.703-1 requires that this amount be obligated on the contract. Even in the event of termination for convenience, the contractor could expect to get no more money from the Government than that amount. Therefore, the contractor has the duty to monitor his costs. When within sixty (60) days hence (taking into account its estimate of what he would expect on a termination for convenience settlement) he will have spent seventy-five percent (75%) of the set amount stated in the schedule, the contractor must notify the contracting officer of that fact. The contracting officer then must either provide more money or terminate the contract for convenience. In any event, if the contracting officer does not continue to fund the contract, the contractor is not obligated to continue performance. He may treat the contract as having been terminated.¹¹ Indeed, 31 U.S.C. § 1342, which prohibits the Government from accepting voluntary services, would compel the contractor to stop performance. It is the operation of the appropriate one of these two clauses which keeps the Government from having obligated itself for "an indefinite and uncertain sum that may exceed the appropriation," and hence, from an Anti-Deficiency Act violation.

By removing from the monetary limitation of the Limitation of Cost or Limitation of Funds clauses the contingent liability which may accrue to the Government through the operation the Insurance--Liability to Third Persons clause, the former clause obligated the Government for a contingent liability "indefinite and uncertain in amount which may exceed the appropriation." Thus the Anti-Deficiency Act was violated every time the Government entered into a contract containing the

clause.

Such was the analysis of GAO when directly presented with the question. In B-201072, May 3, 1982, GAO stated that the clause fell "squarely within those contractual obligations which are prohibited under the [Anti-Deficiency Act and the Adequacy of Appropriations Act, 41 U.S.C. § 11]."¹² Thus, it found illegal a clause of longstanding and widespread use.

It is necessary to go back in time to see how the clause could come into being in the first place. The 1949 edition of Navy Contract Law traces the use of the clause back to early in World War II. Navy Contract Law doesn't cite any authority for the clause, however. It simply says:

Early in World War II, the Navy Department established, with respect to its procurement contracts, the policy of assuming the risk of loss of or damage to Government-owned property, as well as certain liabilities to third persons arising out of the performance of cost-reimbursement contracts....To effectuate this policy, the Secretary of the Navy has approved certain insurance clauses...with respect to third party liability under cost-reimbursement contracts (which clause is entitled "Insurance--Liability to Third Persons"). (Emphasis added.)¹³

From that, one might infer that the use of the clause was simply policy established by the agency. No thought seems to be given to the question of the authority for the clause. In a 1967 Department of Justice memorandum,¹⁴ it was suggested that Title II of the First War Powers Act of December 18, 1941, 55 Stat. 839, might have provided such authority by enabling the President to:

authorize any department or agency * * * to enter into contracts and into amendments or modifications of contracts * * * without regard to the provisions of law

relating to the making, performance, and amendment or modification of contracts * * *.¹⁵

That same memo, however, goes on to cast doubts on the theory that the First War Powers Act was actually used in that regard.¹⁶ First of all, the language of that Act is the same as that of 50 U.S.C. § 1431 (P.L. 85-804). The authority provided thereby has always been viewed as a matter of extra-ordinary relief. Secondly, the memorandum cites two World War II vintage rulings, 40 Op A.G. 225 (1942) and 22 Comp. Gen. 892, neither one of which holds necessarily that the First War Powers Act authorized the making of unlimited indemnity agreements.¹⁷ Furthermore, as described above, 20 Comp. Gen. 632, which pre-dates the First War Powers Act, states that assumption of such third party liability is permissible on an entirely different theory.¹⁸ As a clause, then, its beginnings are not very clear either as to what authority was cited for it, or even whether or not there was any serious consideration given as to what authority might allow for its use.

Nevertheless, the clause, operating without regard to the Limitation of Cost or Limitation of Funds clause, was in use at least from "early in World War II" until the advent of the FAR. The Comptroller General's decision, B-201072, resulted in the current feature of the clause limiting the Government's exposure by the following provision of the clause:

The Government's liability under paragraph (c) of this clause is subject to the availability of appropriated funds at the time a contingency occurs. Nothing in this contract shall be construed as implying that the Congress will, at a later date, appropriate funds sufficient to meet deficiencies.¹⁹

The problems surrounding this solution have already been discussed.²⁰ Basically, there is the question of whether or not it itself is an obligation in advance of appropriations. There is also the question of what is meant by "available appropriations." Furthermore, depending upon the status of funding in the appropriation at the time of the loss, and depending upon how "available appropriations" is defined, there is the objection that the clause provides either illusory benefits to the contractor, or takes funds away from the purposes of the appropriation.

This whole series of problems surrounding the clause, and even GAO's position that it should not be used absent Congressional approval, make this area one of great interest currently. When this issue is coupled with the statutory initiatives involving indemnification,²¹ the entire policy of the Government regarding the assumption of contractor and third party risks may be subject to substantial changes and clarifications.

B.

CLAUSES WHICH MAY VARY THE CONTRACT PRICE

1. Economic Price Adjustment Clauses.

Economic price adjustment clauses are a means to take the risk of fluctuations in labor and material costs out of the pricing of fixed price contracts. The now superseded Defense Acquisition Regulation (DAR) summarized their use as follows:

The fixed price contract with economic price adjustment may be used...when the contracting officer determines that price adjustment provisions are necessary either to protect the contractor and the Government against significant economic fluctuations in labor or material costs or to provide for the upward and downward revision of the stated contract price upon the occurrence of certain contingencies which are specifically defined in the contract. In the establishment of the base levels from which adjustment will operate, contingency allowances shall be eliminated from the base to be set forth in the contract to the extent that adjustment is provided for any particular contingency. Use of this type of contract is appropriate when serious doubt exists as to the stability of market or labor conditions which will exist during an extended period of contract performance and when contingencies which would otherwise be included in the contract price can be identified and covered separately by a price adjustment clause. Price adjustments based on established prices should normally be restricted to industry ²²wide contingencies beyond the control of the contractor.

Those policies have not changed under the FAR.²³ Basically, the various clauses work to eliminate from the price of a fixed price contract any amount that might otherwise be included as a hedge against the possibility of increased costs of performance. If the price of labor or materials goes up from the contractually agreed upon base, the clause may operate to increase the contract price. Conversely, if the price were to vary downward from the agreed upon base, the Government

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would get the benefit of the savings.

The FAR contains three standard economic price adjustment clauses: FAR 52.216-2 Economic Price Adjustment--Standard Supplies, FAR 52.216-3 Economic Price Adjustment--Semistandard Supplies, and FAR 52.216-4 Economic Price Adjustment--Labor and Material.

These standard clauses are uniformly subject to a ten percent maximum increase in price. Thus, on a contract with an established price for labor or materials subject to the clause, the most the price of the contract could vary from the base would be ten percent of the original contract unit price. The cost of the labor or material in question could be no more than 110% of the base price. (There is no limit on the amount of decreases that may be made under any of the clauses.) Thus, the Government's liability for the contingency of labor or material cost escalation is limited to a fixed amount, ten percent of the established price.

2. Incentive Contracting.

Incentive contracting is a means of contracting wherein the contractor's profit will be determined in accordance with a formula that considers the contractor's expected costs to complete the job (the "target cost") with the actual final negotiated cost to complete. Generally, if the contractor's actual costs are lower than the expected target, then his profit will be greater than originally contemplated; and, on the other hand, if his costs are greater than expected, his profit will be lower. DAR explained the workings of an incentive contract thusly:

Under [a firm target] type of incentive contract there is negotiated at the outset a target cost, a target profit, a price ceiling (but not a profit ceiling or floor), and a formula for establishing final profit and price. After performance of the contract, the final cost is negotiated and the final contract price is then established in accordance with the formula. When the final cost is less than target cost, application of the formula results in a final profit greater than the target profit; conversely, when final is more than target cost, application of the formula results in a final profit less than the target profit, or even a net loss. Thus within the price ceiling, the formula provides for the Government and the contractor to share the responsibility for costs greater or less than those originally estimated, as determined by a comparison of negotiated final cost with target cost.²⁴

The theory is that by making the contractor's profit an inverse function of his costs, he will be "incentivized" to keep his costs low. This would benefit the Government in providing an overall lower price.

Because the profit resulting from application of the formula is in inverse relationship to costs, the formula provides the contractor in advance with a calculable profit incentive to control costs. To provide an incentive consistent with the circumstances, the formula should reflect the relative risks involved in contract performance. Thus, it is appropriate in certain procurements to establish a formula which provides for contractor assumption of a considerable major share of total cost responsibility. In such circumstances, when a major share of total cost responsibility is assumed by the contractor, every consideration will be given to establishing target profits which reflect assumption of such responsibility.²⁵

The FAR states a policy that a fixed-price incentive contract is appropriate when:

- (1) a firm-fixed-price contract is not suitable;
- (2) The nature of the supplies or services being acquired and other circumstances of the acquisition are such that the contractor's assumption of a degree of cost responsibility will provide a positive incentive for effective cost control and performance; and
- (3) If the contract also includes incentives on technical performance and/or delivery, the performance requirements provide a reasonable opportunity for the incentives to have a meaningful impact on the contractor's management of the work.²⁶

It needs to be emphasized that while the total contract price may vary somewhat, it is subject to a ceiling price beyond which it cannot vary. Therefore, even if the contractor's cost performance should be so good that technical application of the formula would result in a total price greater than the agreed upon ceiling, the ceiling is the maximum extent of the Government's liability.

The cost to the Government (up to the ceiling price) is contingent upon the contractor's costs. The Government, therefore, has a contingent liability, the maximum extent of which is determinable.

3. Funding the Contingent Liabilities of Economic Price Adjustment Clauses and Incentive Contracting.

Very generally, an "obligation" of the Government may be understood as "a definite commitment which creates a legal liability of the Government for the payment of appropriated funds for goods and services ordered or received."²⁷ With regard to contracts, 31 U.S.C. § 1501(a) provides:

An amount shall be recorded as an obligation of the United States Government only when supported by documentary evidence of--

(1) a binding agreement between an agency and another person (including an agency) that is--

(A) in writing, in a way and form, and for a purpose authorized by law; and

(B) executed before the expiration of the period of availability for obligation of the appropriation or fund used for specific goods to be delivered, real property to be bought or leased, or work or service to be provided;

Thus, an obligation incurred is a definite liability of the Government which must be recorded against the appropriation involved.²⁸ In this way the agencies may keep track of how much of the appropriation has been spent, and how much remains as an "unobligated" balance. A "commitment," on the other hand, has been described as an administrative reservation of funds.²⁹

In the case of contracts with economic price adjustment clauses and in incentive contracting, the regulations require that funds be obligated only for the target or billing price. For example, the DOD Accounting Manual provides:

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...

2. Fixed-Price Contract with an Escalation, Price Redetermination or an Incentive Provision. When the contract is executed, an obligation must be recorded only for the amount of the target or billing price stated in the contract even though the contract may contain a ceiling price in a larger amount.³⁰

Therefore, in the case of a contract with an economic price adjustment clause, no funds are obligated for the maximum ten percent difference between the contract price as determined with or without the operation of the clause. In the case of an incentive contract, no funds are obligated for the difference between the target price and the ceiling price. As a result, unless funds are committed for such purposes, the Government's contingent liability on account of these provisions would remain unfunded.

The accounting regulations, however, do not require a reservation of funds for every possible contingent liability. As observed earlier in the discussion of administrative reservation of funds,³¹ DOD 7220.9-11 instructs as follows:

In the cases of (a) outstanding fixed-price contracts containing escalation, price redetermination, or incentive clauses...there are contingent liabilities for price...increases...which cannot be recorded as valid obligations...Amounts to cover these contingent liabilities should be carried as outstanding commitments pending determination of actual obligations. However, the amounts of such contingent liabilities need not be recorded at the maximum or ceiling prices under the contracts. Rather, amounts conservatively estimated to be sufficient to cover the additional obligations which will probably materialize, based upon judgment and experience, should be committed. In determining the amount to be committed, allowances may be made for the possibilities of downward price revisions. (Emphasis added.)³²

However, GAO's understanding of the Anti-Deficiency Act requires that to the extent the Government is obligated for a contingent liability it must either 1) limit its liability to "available appropriations", or 2) reserve funds to cover the contingency.³³ Furthermore, GAO's present position is contrary to what it said in ³⁴

Comp. Gen. 418 (where it approved of administratively reserving only an amount "to cover the excess of the estimated increases over the decreases"³⁴) and in 42 Comp. Gen. 708 (where it approved of not reserving funds when the happening of the contingency was a mere possibility³⁵). GAO's present understanding of the law as enunciated in 54 Comp. Gen. 824 is that, if the reservation of funds alternative is chosen, such reservation must be sufficient to cover even the possibility of a deficiency.³⁶

Insofar as the practice allowed by the above regulation does not require the reservation of funds sufficient to insure the appropriation against the possibility of a deficiency, it does not comply with the requirements of the Act. The Government could comply by reserving the ceiling amount. The problem with reserving the maximum amount of liability is in the tying up of funds that may never be spent. The lack of good business sense or accepted accounting practice in so doing has already been discussed.³⁷ Likewise, the alternative means of compliance, limitation of liability, has its own problems.³⁸ The alternative of allowing such type of contracting as an exception to the Anti-Deficiency Act would require Congressional action.³⁹

The author is unaware of the extent to which the operation of economic price adjustment clauses or incentive clauses may be responsible for creating actual deficiencies in appropriations. They are possibly not an important factor. However, it is also the creation of the obligation without assurance of adequate appropriations which violates the Act. Therefore, any argument that the chances may be remote of there being an actual deficiency is not to the point. There

is a violation of the Act whenever such a clause is used without either a limitation of liability or a reservation of funds.

The only way to avoid this conclusion would be somehow to distinguish 34 Comp. Gen. 418 from 54 Comp. Gen. 824 and cases following it. There appears to be no logical basis upon which to do this. Surely in terms of the Anti-Deficiency Act there is no difference between contingent liabilities which arise from indemnification agreements and those which arise from economic price adjustments or incentive contracting. The author, therefore, leaves with GAO and the agencies the question of how, in light of the Anti-Deficiency Act, the practices allowed by the accounting regulation may be justified. Alternatively, GAO and the agencies are challenged to seek from Congress the means either to comply with the Act or to be excused from its constraints.

C.

CONSTRUCTIVE CHANGES AND DIFFERING SITE CONDITIONS

Constructive changes and differing site conditions have two elements in common. They both involve the possibility of payment under a contract for work or expenses that were not contemplated or expected by the parties at the time of contract execution. Secondly, in performing the extra effort, the contractor would be entitled to additional compensation. They are different, however, in that constructive change is a doctrine which developed apart from a contract clause. While current contract language recognizes the doctrine,⁴⁰ it functions, by and large, apart from contractual language. Differing site conditions, on the other hand, is the subject of a standard

contract clause.⁴¹

That a constructive change may occur or that differing site conditions may be encountered are both contingencies for which the Government may become contractually liable. How these contingent liabilities relate to the Anti-Deficiency Act is the subject of this section.

1. Constructive Changes.

a. Constructive Changes Described.

One of the major uses of the Changes clause is to serve as the basis for administrative claims by a contractor for additional compensation for extra work performed during the course of a Government contract. When a contractor performs work beyond that required by the contract, and it is perceived that such work was ordered by the Government or caused by Government fault, it is found that a constructive change has occurred. Under common law contractual analysis such fact patterns would more likely be placed under theories of implied contract or breach of contract, but the administrative procedures developed for the resolution of disputes in Federal contracts prevented the boards of contract appeals from using these theories. Hence, these boards developed the alternate theory of constructive changes.

....

While the scope of constructive changes has become very broad, one board described the elements of such changes as being simple in their nature. See Industrial Research Associates, Inc., DCAB WB-5, 58-1 BCA ¶ 7069 (1968) at 32,685-86:

As we see it, the constructive change doctrine is made up of two elements---the "change" element and the "order" element. To find the change element we must examine the actual performance to see whether it went beyond the minimum standards demanded by the terms of the contract. But, this is not the end of the matter.

The "order" element also is a necessary ingredient in the constructive change concept. To be compensable under the changes clause, the change must be one that the Government ordered the contractor to make. The Government's representative, by his words or his deeds,

must require the contractor to perform work which is not a necessary part of his contract. This is something which differs from advice, comments, suggestions, or opinions which Government engineering or technical personnel frequently offer to a contractor's employees.

Using this analysis, any Government action or communication could be characterized as a constructive change if it was found to have forced or induced the contractor to undertake extra work. The result is that a wide variety of occurrences during contract performance⁴² have been held to be constructive changes.

The authors of the above quote have categorized the "wide variety of occurrences" which may be found to be constructive changes to include 1) disagreements over contract requirements, 2) Government provision of defective specifications and nondisclosure of information, 3) acceleration of the contract schedule, and 4) hindrance or failure to cooperate.⁴³ In addition, a Government caused delay, such as a constructive suspension of work, may be treated as constructive change.⁴⁴

b. Constructive Changes and Fund Availability.

The standard changes clauses give the Government very broad discretion to order changes within the scope of the contract work, and allow the contractor an "equitable adjustment" in the contract price on account of such a change.⁴⁵ The difference between an ordered change and a constructive change is that the latter type simply occurs without regard to the normal administrative controls on contract modifications. Those controls are described in FAR Part 43. The policy regarding contract modifications is as stated in FAR 43.102, Policy:

(a) Only contracting officers acting within the scope of their authority are empowered to execute contract modifications on behalf of the Government.

....

(b) Contract modifications, including changes that could be issued unilaterally, shall be priced before their execution if this can be done without adversely affecting the interest of the Government. If a significant cost increase could result from a contract modification and time does not permit negotiation of a price, at least a maximum price shall be negotiated unless impractical.

Anti-Deficiency Act concerns in ordered changes are addressed by the policy set forth in FAR 43.105, Availability of funds:

(a) The contracting officer shall not execute a contract modification that causes or will cause an increase in funds without having first obtained a certification of fund availability, except for modifications to contracts that--

(1) Are conditioned on availability of funds (see 32.703-2); or

(2) Contain a limitation of cost or funds clause (see 32.704).

(b) The certification required by paragraph (a) above shall be based on the negotiated price, except that modifications executed before agreement on price may be based on the best available estimate.

Therefore, subject to the above exceptions, the contracting officer is required to have available funds before entering into the contract modification.

However, constructive changes may not be identified until after costs have been incurred. FAR 43.104, Notification of contract changes, recognizes this fact:

(a) When a contractor considers that the Government has effected or may effect a change in the contract that has not been identified as such in writing and signed by the contracting officer, it is necessary that the contractor notify the Government in writing as soon as possible. This will permit the Government to evaluate the alleged change and (1) confirm that it is a change, direct the mode of further performance, and

plan for its funding; (2) countermand the alleged change; or (3) notify the contractor that no change is considered to have occurred. (Emphasis added.)

The constructive change doctrine, therefore, creates the possibility of an Anti-Deficiency Act violation. There is probably no way to avoid this possibility without doing away with the doctrine altogether.⁴⁶ The various notice requirements in the changes clauses attempt to limit the Government's retrospective liability. Particularly, the construction contract changes clause states that no costs on account of the constructive change "shall be allowed for any costs incurred more than 20 days before the Contractor gives written notice [of the change]"⁴⁷ However, the courts and boards do not uniformly uphold these notice provisions.⁴⁸ As the constructive change doctrine does show such resiliency and resistance to limitation, the possibility of creating a deficiency on its account will probably remain.

c. Contractor's Recovery When Constructive Change Results in Deficiency.

In light of the fact that a constructive change may cause a deficiency in an appropriation, who must bear the risk of that possibility? In other words, "May a contractor recover his costs on account of a constructive change which causes a deficiency in the appropriation?" The question should be able to be answered by reference to the section in Chapter II dealing with the status of contracts when the supporting appropriation becomes deficient.⁴⁹ There, the rule was stated that if the contractor had either actual or constructive notice of the deficiency, he could not recover. If the contract were

funded from a general appropriation which might support any number of contracts, he would not normally be charged with notice. If, however, the contract were funded from a specific appropriation or there were specific statutory spending limitations applicable, he would be charged with notice, barring recovery.

However, where the deficiency is caused by events which may be characterized as constructive changes, the Court of Claims has modified its position denying recovery in the case of specific statutory funding limitations. In Anthony Miller Inc. v. United States⁵⁰ the court dealt with a funding limitation of \$16,500 per unit of housing constructed under Government mortgage guarantees pursuant to the Capehart Act.⁵¹ The contractor had completed performance, and was entitled to recover well over \$16,500 per unit but for the ceiling imposed by the Act. The Government took the position that the ceiling of \$16,500 was the limit of its authority to make payment, and that the contractor had notice of this limitation. The Court of Claims, however, found that the ceiling was not intended by Congress to impose an absolute limit on expenditures, but stated that the contractor could not totally disregard the ceiling price. The court distinguished between costs within a contractor's control, such as "simple extras," and those which are beyond his control, such as extra costs to overcome defective Government specifications. The court allowed recovery for the Government caused increases in cost, but denied recovery for the extras.⁵²

Likewise, in a similar situation in Ross Construction Corp. v. United States⁵³ the contractor was faced with a per unit spending

limit imposed by the Capehart Act. The contractor had incurred costs in excess of the limit on account of changed conditions, defective drawings, and erroneous Government interpretation of the specifications. The Government conceded that the contractor was entitled to the excess costs unless precluded by the funding limitation.⁵⁴ The court allowed recovery for these costs.⁵⁵

The costs involved arose from situations that could have been handled as constructive changes. This would indicate that at least where the change is the result of Government fault, contractor recovery would not be barred by funding limitations. But, where the change might result from something other than Government fault, the court in Anthony Miller warned the contractor:

In order to prevent an accidental over-obligation of funds, the contractor should, before performing the extra work, insist on a formal written commitment by the [agency] that the extra will not cause the total cost to exceed the...limitation....The contractor knows the amount that has been expended and the total amount of the insurable mortgage. He should at all times be wary of the limit. We realize that this adherence to formalities places more than normal responsibility on the contractor, but we think it is required.⁵⁶

In Ross Construction the court added that to place such a requirement on the contractor would serve "the legislature's prime purpose to prevent escalation of costs...without turning the contractor into a helpless victim of the [Government's] fault or of unexpected external conditions." (Emphasis added.)⁵⁷ In Ross Construction the court also acknowledged the similarity between the spending limitation imposed by the Capehart Act and that imposed by the Anti-Deficiency Act.⁵⁸ Therefore, changes resulting from both Government fault and

unexpected external conditions may not bar recovery even in face of funding limitations.

It should be noted that these cases may represent a departure from the earlier Supreme Court case, Sutton v. United States.⁵⁹ In that case, a specific appropriation was made for the dredging and excavation of a channel into Tampa Bay, Florida. Due to the fault of Government inspectors more work was done than could be funded from the appropriation. This situation would fall within the definition of constructive change. The "order" element is satisfied by the work having been undertaken due to the mistaken direction of the Government inspectors, and the change element is satisfied by the fact that the only work supposed to have been accomplished was that which could have been adequately funded within the specific appropriation. The Supreme Court denied recovery to the plaintiff-contractor on the theory that the amount of the specific appropriation was an absolute limit on the Government's authority to pay, and the contractor was deemed to have had notice of the limits of this authority.⁶⁰ That the deficiency was due entirely to the fault of the Government inspectors, and that the contractor had reasonably relied upon the inspector's errors did not alter the outcome.⁶¹ Therefore, it cannot be said with certainty what would be the result if the Supreme Court were presented with a situation such as was present in Anthony Miller or Ross Construction.

d. Source of Funds for Contractor Recovery in Constructive Change Cases.

It should be noted that in the case where, in the face of a deficiency, a court or board would find that a constructive change had occurred and allow the contractor to recover, the contractor is not paid out of the relevant appropriation. (This should be obvious because there is no money in the appropriation.) Rather, he is paid out of the "judgment fund" created by 31 U.S.C. § 724a. This fund is initially used to pay all court and board judgments rendered against the United States.⁶²

There is some rationality to this where the Government contests that a constructive change has occurred. In fact, if the Government were successful in arguing that no change had occurred, then there would be no deficiency. However, the wisdom of this practice is subject to question in the situation where the Government does not contest that a constructive change has occurred or that the contractor is otherwise due the money, but simply doesn't pay the contractor because it has no money in the appropriation. In such instances, where the courts have allowed recovery, they have done so as a result of contractor suits brought for breach of contract. The breach was the Government's failure to pay in accordance with the terms of the contract.⁶³ The scenario, then, is that 1) contractor performs the work, 2) Government acknowledges that the contractor has done the work, 3) Government doesn't pay for the work (because it has no money in the appropriation), 4) contractor sues the Government for breach of contract in the Claims Court, and 5) the contractor recovers from the

judgment fund. This scenario suggests a means whereby the Anti-Deficiency Act may easily be circumvented.

So long as the courts make available the judgment fund to fund deficiencies, there may be little incentive for either industry or the agencies to take more seriously the requirements of the Anti-Deficiency Act. In fact, two comments from outside the Government in response to the GAO's decision declaring the Insurance--Liability to Third Persons clause illegal indicate that industry appears to regard the above described series of events virtually as standard operating procedure. In its letter to the Comptroller General regarding B-201072, the Public Contracts Law Section objected to GAO's limitation of liability language, among other reasons, because, "[T]his limitation may preclude the contractor's recovery in the U.S. Claims Court of the difference, if any, between the amount available for reimbursement under the contract and the amount that may be recovered under the Court's judgment."⁶⁴ GAO required the limitation of liability in order that the absolute maximum extent of Government liability would be contractually understood. This was in order to comply with the Anti-Deficiency Act. But, the Public Contracts Law Section objects, seeming to take for granted that even in the face of the funding limitations of the Anti-Deficiency Act, contractors should be able to recover in the Claims Court.

Likewise, regarding GAO's limitation of liability language, the Aerospace Industries Association of America protested to the Defense Acquisition Regulatory Council:

The provision suggested by GAO may serve to bar a contractor's action in the Court of Claims for breach of the Government's promise to reimburse the contractor's costs. This is inconsistent with the current practice where a contractor can obtain full compensation in the Court of Claims and Congress regularly appropriates funds to satisfy the Court's judgments.

This evidences private sector recognition of the possibility of deficiency situations. It also evidences that even given the possibility of deficiency situations, industry shows a willingness to contract with the Government, understanding that the Claims Court may "bail it out" of any deficiency situation. It would seem that to the extent this procedure is regarded as the normal way of doing business, the Anti-Deficiency Act and its purposes have been thwarted. In light of that, it may be appropriate for the courts or the legislature fairly to place even greater responsibility on contractors to ensure that they are not performing work which causes the financing appropriation to become deficient.

On the other hand, Fenster and Voltz believe the Government to be at fault in not planning the funding for these types of contingent liabilities:

The Government is required by the [Anti-Deficiency Act] and its related statutes, to have funds currently available to cover at least the governments's own estimate of the value of such obligations [as may arise from disputed claims, escalation costs, amounts due the contractor by reason of defective specifications, and many other such obligations]. The Comptroller General appears to agree:

[T]he recording of obligations under 31 U.S.C. § [1501] is not the sole consideration in determining violations of [the Anti-Deficiency Act and the Adequacy of Appropriations Act]. We believe that the words "any contract or other obligation" as used in [the

Anti-Deficiency Act] encompass not merely recorded obligations but other actions which give rise to Government liability and will ultimately require the expenditure of appropriated funds. [O]ne example of such action [is] conducted [sic] by a Government agency which would result in Government liability through a clear line of judicial precedent, such as through claims proceedings. [Emphasis added].

This is a clear and accurate statement of the law. If government procurement agencies would follow it, violations of the Act would be far less frequent due to a more realistic appraisal of the extent of the obligations actually incurred if not yet due for payment. Government officials continue to be obsessed with a "cash flow" misinterpretation of the Act, however. Our experience has shown that the government has not changed its practices in this regard.
(Citations omitted.)⁶⁶

As an example of their experience, Fenster and Voltz cite an instance where the Navy was relying "upon a reserve fund with as little as \$200 million available to cover obligations which by the Navy's own estimate, [were] worth at least \$2.7 billion."⁶⁷

It would therefore appear that consideration needs to be given to a means whereby both the Government and its contractors would be "incentivized" to take more seriously the requirements of the Anti-Deficiency Act. The simplest way to do this would be to eliminate the judgment fund as the means to fund deficiencies. To do this, and to be fair to contractors, however, would necessitate making the law clear that in the face of a deficiency and without some added assurance of payment, the contractor would have the right to stop work on the contract. However, as discussed in Chapter II, the law is not at all clear on that point, and at times, the Government has taken the position that contractors have no such right.⁶⁸

2. Differing Site Conditions.

a. Description of the Clause.

The Differing Site Conditions clause⁶⁹ is a required clause for all fixed-price construction contracts when the amount thereof is expected to exceed the small purchase limitation and is optional otherwise.⁷⁰ The background and purpose of the clause have been explained as follows:

One of the major risks of a construction project is the determination of the subsurface or physical conditions which will be encountered. Unless a contractor has made an extensive analysis of these conditions by means of borings or otherwise, he would probably have to include a contingency to cover unfavorable conditions if he is required to assume the full risk. On the other hand, the Government normally has information as to these conditions at its disposal prior to soliciting bids on the construction project and does not want each contractor to incur the expense of making borings or underground investigations. The Government's response to this situation has been to relieve its contractors of the risk of encountering subsurface or physical conditions which differ from those indicated in the contract or ordinarily encountered. The means of relieving the contractor of this risk is by using a standard clause promising an equitable adjustment in the event a different condition is encountered. Note that the clause also removes some risk from the Government by providing for an equitable adjustment decreasing the price if the conditions are found to be better than expected.⁷¹

GAO has recognized the use of the clause in 37 Comp. Gen. 691 (1958), and, applying accounting rules, has stated:

Regarding the excavation contracts, there is always a possibility that material may prove to be harder, denser and more difficult to excavate than could have been anticipated from the plans and specifications or from other available information. This possibility alone does not constitute a contingent liability requiring recognition in a financial statement or its footnotes. But circumstances may arise in connection with the contracts for construction...that would

require disclosure before any claims had been made because of their possible impact on the [Government] Corporation's financial condition. No hard and fast rule can be laid down as to the circumstances that would require disclosure. Judgment would have to be exercised with⁷² respect to the possible financial implications.

This was obviously being written from an accounting perspective. The Comptroller General was concerned with presenting an accurate financial picture of the Saint Lawrence Seaway Development Corporation, not with Anti-Deficiency Act violations. Furthermore, this opinion predates 54 Comp. Gen. 824 (1975) by several years. Thus, its importance today is only in that it demonstrates that GAO is aware of the clause and how it operates.

The clause provides that the contractor is entitled to an upward equitable adjustment in the contract price if the physical conditions at the construction site cause greater effort and expense than contemplated by the parties. The Government assumes the risks of more onerous physical conditions at the site.

b. The Differing Site Conditions Clause and the Anti-Deficiency Act.

Unlike the economic price adjustment clauses, which limit the Government's liability to, at most, ten percent of the agreed upon costs,⁷³ or incentive contracting which is subject to a maximum ceiling price,⁷⁴ the contingent liability assumed by this clause is not limited in amount. There is no maximum dollar limit or formula whereby a cap on the Government's exposure could be determined. The contractor is entitled to an equitable adjustment based upon the increased costs, whatever they might be.

The obligation is indeterminate in amount, and, therefore, may exceed the amount in the relevant appropriation. This would appear to be an Anti-Deficiency Act violation.

c. Effect of the Notice Provisions.

An Anti-Deficiency Act violation, however, may be prevented by the clause's requirement that the contractor give notice to the Government of the materially differing conditions before the conditions are disturbed.⁷⁵ If notice is given before conditions are disturbed, then presumably the notice has also been given before any additional expenses would have been incurred in site preparation. If, upon investigation, the contracting officer determines that there are insufficient funds in the appropriation to complete the project in light of the differing site conditions, he may have available the option of terminating the contract for convenience. In Torncello & Soledad Enterprises, Inc. v. United States⁷⁶ the court said that termination for convenience is available to the Government in "situations where the circumstances of the bargain or the expectations of the parties have changed sufficiently that the [termination for convenience] clause serves only to allocate risk."⁷⁷ As the Government has assumed the risk of differing site conditions, it therefore, may have the right to determine the course of action in light of those changed conditions.

On the other hand, there is a question if Torncello could not be read another way. That is, if the Termination for Convenience Clause is only available to the Government as a risk allocating device in the situation where the expectation of the parties change beyond those

bargained for, may the Government exercise its termination for convenience right in a situation where the parties have already bargained regarding the possibility of changed conditions? That risk has already been allocated by the Differing Site Conditions clause to the Government. The only risk remaining to be allocated by the Termination for Convenience Clause would be the risk of adequate funding availability in light of the changed conditions. While it is unlikely that Torncello could be read so broadly as to deny the Government the right to terminate in the face of a deficiency or potential deficiency,⁷⁶ the Differing Site Conditions clause itself does not address the Government's rights, if any, in the face of changed conditions. Only the contractor's right to an equitable adjustment is stated.

c. Conclusion.

Thus, although on its face the clause appears to obligate the Government for an indeterminate contingent liability, the practicalities of the situation in which it would come into play are such that no expenses should be incurred without contracting officer approval. So long as the contracting officer has the option to terminate for convenience, no overobligation should be created. If the contracting officer were to give approval to proceed in light of the differing site conditions and without considering the funding situation, he would be doing so at the peril of causing an Anti-Deficiency Act violation.

D.

TERMINATION ISSUES

The Government always retains the right to itself to terminate its contracts for convenience. This right is stated in the Termination for Convenience clause.⁷⁹ The clause represents such a basic procurement policy of the Government that the clause will be "read into" any Government contract in which it was inadvertently left out.⁸⁰ In the past the Government's right to terminate for convenience has been held to be virtually unfettered.⁸¹ However, the Torncello case⁸² limits the Government's right to use the clause to situations involving risk allocation. But, the strict holding of Torncello is only that the Government may not use the clause to exculpate itself from a requirements contract only to have the contract work performed (less expensively) otherwise.⁸³ Therefore, the Government's right to terminate contracts for convenience remains quite broad.

The obligations of the Government upon termination for convenience are as stated in the clauses.⁸⁴ They include payment for costs incurred, profit on work done, and the costs of preparing the termination settlement proposal. In a breach of contract situation, the contractor's recovery may also include anticipated profits. This is denied under the Termination for Convenience clause. This is the basic difference in recovery between breach of contract and termination for convenience.⁸⁵ The Anti-Deficiency Act question raised by the exercise of the contractual right to terminate for convenience is whether or not the Government will have enough money available to fund

its termination liability. If it is assumed that the amount of a termination settlement can never exceed the cost to complete the contract, and if the contract were adequately funded at execution, then there would never be an Anti-Deficiency Act problem in the event of a termination for convenience. Indeed, if it cost more to terminate the contract than to complete it, then the economics of the situation would dictate that the Government not exercise the Termination for Convenience clause.

Therefore, the only situation in which the Anti-Deficiency Act should create problems on termination is where the contract was not adequately funded to completion from the start. There are two areas in which this is the case. Both of them involve multiyear contracting, and the problem is the funding of termination liability. The first case involves multiyear contracting and the failure of Congress to continue to fund multiyear contracts for years beyond the currently funded year. The second one concerns termination liability accruing to the Government from the operation of the DOD Special Termination Costs clause. This section analyzes the procedures surrounding multiyear contracting and the use of the Special Termination Costs clause in light of the Anti-Deficiency Act.

1. Multiyear Contracting.

a. The Concept of Termination Liability in Multiyear Contracting.

The concept of multiyear procurement has already been introduced in Chapter IV. C. 2. There the statutory basis for such contracting was discussed. The concept of termination for convenience was briefly described above. Another concept essential to an understanding of termination liability in multiyear contracting is "cancellation." "Cancellation" is a term unique to multiyear contracts. It is, "The unilateral right of the Government not to continue contract performance for subsequent fiscal years' requirements. Cancellation is effective only upon the failure of the Government to fund successive [fiscal year] requirements under the contract."⁸⁶ This section focuses on the contingent liability that accrues to the Government from termination liability on multiyear contracts. Termination liability is the maximum cost the Government would incur if a contract is terminated.⁸⁷ "In the case of a multiyear contract terminated before completion of the current fiscal year's deliveries, termination liability would include an amount for both current year termination charges and outyear cancellation charges."⁸⁸ The reason it is stated that termination liability would include both types of charges before completion of the current fiscal year is that at the end of the fiscal year, the current year's work would be completed; there would be no work left to be terminated, and hence no termination liability on that account. Only cancellation charges would remain. (Of course, the Government would have to pay for the completed work.)

Current year termination settlements would include the amounts

referred to above: cost of work completed, profit on that work, and expenses of the termination settlement. The cost of these charges would be funded with current program funds (the cost of termination being less than the cost of completion of the entire year's purchase). The "outyear cancellation charges" would include the contractor's unrecovered nonrecurring costs and may also include recurring costs associated with the cancellation.⁸⁹ Nonrecurring costs include:

Those production costs generally incurred on a one-time basis including such costs as plant or equipment relocation; plant rearrangement; special tooling and special test equipment; preproduction engineering; initial spoilage and rework; pilot runs; allocable portions of the costs of facilities to be acquired or established for the conduct of the work; costs incurred for the assembly, training, and transportation of a specialized work force to and from the job site; and unrealized labor learning.⁹⁰

Thus, it may be argued that these costs are not truly contingent liabilities. They are costs that the contractor will recover no matter what happens to the program being acquired pursuant to a multiyear contract. It is simply a matter of among how many units these costs will be spread. They are all fixed costs. They will be divided among the total number of units produced. If the multiyear contract is seen through to completion, they will be spread over a greater number of units. If the multiyear contract is cancelled before completion, the cost in effect will be divided among a smaller number of units (the number of units completed). As far as the contractor is concerned, these costs are simply a matter of "pay me now, or pay me later." This is the sense in which the nonrecurring costs of a cancellation charge on multiyear procurement are not "truly contingent."

However, they are contingent in the sense that, on account of the cancellation, they are unanticipated costs of the fewer number of units produced. They will only be incurred with respect to the completed units (allocated to the completed units) if the contract is cancelled or terminated.

On the other hand, the recurring costs of cancellation or termination of a multiyear contract are truly contingent. They are, "Production costs that vary with the quantity being produced, such as labor and materials."⁹¹ The labor costs involved in terminating a contract (such as superintendence and the like) are not the labor costs involved in completing the contract. As they would only be incurred in the event of cancellation, they are "truly contingent."

10 U.S.C. § 2306(h)(2)(B) allows the cancellation provisions of a multiyear contract to include both nonrecurring and recurring costs. As will be discussed below, neither of these costs is presently funded.

b. GAO's Legal Analysis of Funding Requirements for Multiyear Contracting.

In 48 Comp. Gen. 497 (1969) the Comptroller General considered the propriety of contracting in a manner substantially similar to multiyear, although without benefit of statutory authorization. The situation involved the leasing of automatic data processing equipment. The lease was for a one year period with renewal options. In the event the renewal options were not exercised, the Government would become liable for an additional charge, not unlike a cancellation charge on a multiyear contract. GAO approved of this practice with the following proviso regarding funding:

[W]e have no legal objection to contracting for reasonable periods of time in excess of one year subject to the condition that sufficient funds are available and are obligated to cover the costs under the entire contract. Nor...would we have any objection under revolving funds to contracts for a basic period with renewal options, provided funds are obligated to cover the costs of the basic period, including any charges payable for failure to exercise the options. (Emphasis added.)⁹²

The maximum liability to the Government on any such contract would be 1) the cost of performance for the funded period plus 2) any costs arising in the event the contract should not be continued into the subsequent period. Those costs are the "cancellation" or "termination" charges. So long as the Government had obligated sufficient funds for the basic period of the contract and had either obligated (assuming the liability met the requirements for a valid obligation, which it probably would not⁹³) or committed (administratively reserved) funds for the termination liability, there could not be an Anti-Deficiency Act violation. The Government would always have available sufficient funds to pay its maximum liability.

The only options available to the Government at the end of the funded term would be to fund a subsequent term or terminate. As funding the subsequent term is contingent upon an appropriation of funds, the only way to ensure presently that the Government has adequate funding is to reserve the termination liability. Therefore, GAO concluded that funding the termination liability was required by the Anti-Deficiency Act.⁹⁴

c. Congressional "Policy" on Funding Termination Liability.

About the same time as GAO was opining thusly, the House of Representatives Committee on Appropriations reported on the DOD Appropriation Bill, 1968. This was prior to the time of the enactment of the 1981 amendments to 10 U.S.C. § 2306, giving statutory recognition to multiyear contracting. The budget requests submitted by the Department had included amounts to fund termination liability on multiyear contracts. Including such amounts was in keeping with the funding requirements as put forth in GAO's above quoted opinion. However, regarding the practice of funding termination liability, the Committee said:

One of the methods utilized by the Department of Defense to achieve economies in Defense procurement has been the use of multiyear contracts. Such a procedure enables the military service concerned to present to industry sizable procurement packages, which generally results in more interest in the industrial community and in more satisfactory competitive procurements. It provides a stability in production which frequently reflects decreased costs to both the contractor and the Government. The use of this method of contracting has been particularly successful in procurement programs of the Department of the Army. In the past few years it has also been successfully utilized in the Navy, primarily in the shipbuilding program. A feature of this program in the past has been the funding of potential termination charges in the initial request for appropriations. These charges would, of course, only be incurred in the event it was necessary for the Government to terminate the contract for reasons other than contractor liability. Little, if any, use has been made of these potential termination charges to date. As a result, they have been applied systematically to subsequent procurements with some reduction in total appropriation requirements. The growing use of this method of contracting has, however, led to the potential of tying up considerable sums of money for potential termination charges in various programs. The Committee feels that, since the Government is basically a self-insurer and since this method of procurement contracting has proved itself as a proper and reliable

means of procurement management this policy can be changed. Accordingly, it has deleted the funds requested for termination charges in multiyear contracts proposed to be initiated with funds approved in the fiscal year 1968 program. This has resulted in decreases in the appropriations for the Army program for the procurement of equipment and missiles of \$32.9 million, and in the Navy shipbuilding and conversion program of \$14 million. Should termination charges be required at a later date for any of these programs, the Committee will cooperate with the Department of Defense⁹⁵ in making such funds available.

The expressed theory rationalizing the failure to fund these liabilities betrays the Committee's failure to understand the difference between the Government's policy of self-insurance and fiscal law.⁹⁶ Being a self-insurer of one's own property and tort liability has nothing to do with creating contractual obligations. But, creating contractual obligations has everything to do with the Anti-Deficiency Act.

In any event, Congress chose, therefore, not to fund the termination liabilities in question. As a result of any multiyear contracts entered into on the affected programs, the Government became obligated for unfunded contingent liabilities. GAO's analysis requires all contingent liabilities not limited in amount to available appropriations or entered into pursuant to "express statutory authority" to be funded. Therefore, unless it can be construed to fall within the "unless authorized by law" exception to the Act, the failure to fund these liabilities would amount to a violation of the Anti-Deficiency Act.

GAO dealt with this question in B-159141, Aug. 18, 1967. That case presented a situation factually similar to the above described case where on a committee recommendation, Congress declined to fund the

Government's termination liability. The matter involved the FAA and its termination liability on the supersonic transport (SST) program. The House Appropriations Committee directed the FAA not to reserve any amounts for termination liability, and amounts therefor were deleted from the House version of the 1968 budget.⁹⁷ FAA wrote GAO asking for comment on the following proposition:

Assuming no contrary intent is indicated by the Senate, [the FAA] would consider the...language of the House Report as a clear recognition of the Government's obligation to refund the contractor's cost shares in the event of a termination for convenience or failure to fund a cost overrun. We would also view this language as a Congressional authorization--in fact a mandate--for the FAA to fund the SST contracts without maintaining any reserve for this purpose.⁹⁸

GAO responded:

Resolution of the questions presented by you involves the proposition of whether the direction of the Committee on Appropriations as set forth in the House Report No. 484, coupled with the passage of the appropriation act with reductions as recommended and explained in the committee report, may be viewed as constituting the proposed action as one "authorized by law" within the meaning of that term as used in the "Anti-Deficiency Act." We believe that such legislative action affords ample support for an affirmative conclusion to the proposition. The course of action to be taken by the Federal Aviation Administration is clearly spelled out, the obligation of the Government to the contractors is recognized, and it is contemplated by the Committee that such action will result in better utilization of financial resources coupled with closer⁹⁹ and tighter control by Congress over program costs.

Therefore, it would appear that oversight committee recommendation or direction not to fund a contingent liability reserve coupled with Congressional concurrence as evidenced by a declination to appropriate funds for such a reserve is within the "unless authorized by law"

exception to the Act. It is tantamount to the express statement of contract authority, "without regard to an appropriation therefor."

What is most telling about this case, however, is not that GAO found in essence that there could be "contract authority by implication." Rather, it is that the question had to be dealt with at all. Congress' "direction" was such that the agency could not be sure that, if it followed that direction, it would not be violating the Anti-Deficiency Act. One has to question why Congress, itself, could not operate within the context of clear, accepted, familiar terms of art when approaching such matters. And, the issue was not so clear that, in answering the question, GAO could provide a simple, "yes." Instead, the best they could do was state that there was "ample support for an affirmative conclusion to the proposition." (That is, in GAO's opinion, "Yes.")

Nevertheless, in consonance with such Congressional direction as described above, the DOD Accounting Manual provides:

In the case of multi-year contracts which provide for cancellation charges in the event it is necessary for the government to cancel the contract for reasons other than contractor liability, the contingent liability is not recorded as a commitment. Any such cancellation charge must be recorded as an obligation when it becomes necessary to cancel the contract and the contractor is so notified.¹⁰⁰

d. The Legal and Practical Effects of Congressional Decision Not to Fund Termination Liability.

Whether or not this situation violates the Anti-Deficiency Act, there may still be a question about the ability of a contractor to recover in the Claims Court. If perchance an affected program should be terminated without sufficient funds to pay the termination liability, could the contractor recover in the court? This issue has never been litigated. However, certain opinions have been expressed. Fenster and Voltz argue that an appropriation bill cannot repeal by implication permanent legislation:

[T]he Supreme Court has stated that when it is faced with an appropriation which either violates or repeals by implication the existing law, it will enforce the law and ignore the appropriation. In Tennessee Valley Authority v. Hill (The Snail Darter Case), the Court in effect took the position (1) that it would under almost no circumstances find a "repeal by implication"--especially a selective repeal which purports to leave the underlying law untouched; and (2) that if Congress did not like the consequences of rigorous enforcement of its permanent legislation, it should act directly to change the law, not try to have things both ways, by funding government actions which violate the law.¹⁰¹

They make this argument as rebuttal to the proposition that contracts in a deficient funding status can be "ratified" by Congress making an appropriation to fund the deficiency. The situation at hand is the converse of that. In this situation Congress is choosing not to fund a liability; without funding or express statutory authority, such an unfunded liability constitutes a violation of the Act. Furthermore, the contractor would necessarily be on notice that no funds have been appropriated for the termination liability. That is Congress' stated

policy. Therefore, the contractor should not be able to recover if the matter were to go to court.¹⁰²

In 51 Comp. Gen. 598 (1972), GAO came to a similar conclusion regarding an unfunded contingent liability. There the Navy was considering entering into long term ship leases:

The charters will provide an initial term of 5 years following the construction period and either with options to renew for fifteen consecutive 1-year periods or with optional renewal provisions for three consecutive 5-year periods with the Government having the privilege to terminate at the end of every 6-month period.¹⁰³

The leases required the payment of termination charges in the event any of the renewal options should not be exercised. GAO said:

[The Department quotes] a sentence from 48 comp. Gen. 497 indicating that we have no objection under revolving funds to contracts for a basic period with renewal options, providing funds are obligated to cover the cost of the basic period, including any charges payable for failure to exercise the options. The instant proposal is different however in that no cash is being set aside to cover the termination charges for the failure to exercise any of the options. This is authorized during the fiscal year 1972 by section 739 of the Department of Defense Appropriation Act, 1972...¹⁰⁴

GAO discussed that section as follows:

Also, section 739 of the Department of Defense Appropriation Act, 1972...provides as follows:

During the current fiscal year, cash balances in working capital funds of the Department of Defense established pursuant to section 2208 of title 10, United States Code, may be maintained in only such amounts as are necessary at any time for cash disbursements to be made from such funds: Provided, That transfers may be made between such funds in such amounts as may be determined by the Secretary of Defense, with the approval of the Office of Management and Budget.

An examination of the legislative history of this provision discloses that language similar thereto was contained in the Supplemental Defense Appropriation Act, 1966...In approving such provision the House Committee on Appropriations in Report No. 89-1316 stated that--

The recommended Section 101 provides authority for the Secretary of Defense to transfer cash balances between working capital funds of the Department of Defense in such amounts as he may determine, with the approval of the Bureau of the Budget. This language is intended to provide operational flexibility as among the working capital funds, particularly the stock funds of the various military departments and the Department of Defense so as to alleviate situations wherein one fund may have an excess of cash while another might be temporarily short of cash. This section also contains language prescribing minimum cash balances for working capital funds in such amounts as are necessary at that time to meet cash disbursements to be made from such funds. This authority provides, in effect, relief from certain administrative interpretations of [the Anti-Deficiency Act] in such a manner as to minimize the amounts of cash necessary to be tied up in an inactive status. (Emphasis added.)¹⁰⁵

This led GAO to conclude:

[T]he Secretary of Defense, with the approval of the Office of Management and Budget is authorized during the fiscal year 1972 by section 739 of the Department of Defense Appropriation Act, 1972, to transfer funds between the Industrial Funds of the three military departments. In view of the various statutory authorities relating to the Industrial Funds and the assurance of DOD that the obligational availability of the Navy Industrial Fund in fiscal 1972 is more than sufficient to cover obligations for the total charges permitted under the initial period and all succeeding obligational periods...we cannot question the legality of the proposed arrangement.¹⁰⁶

GAO thus reasoned that Congress had "authorized" the creation of an unfunded contingent liability. At least it was unfunded in that no money was being reserved or otherwise earmarked for the potential

liability. Rather, the Department was looking to its "obligational availability" to fund the liability in the event it should come about. DOD was looking to unobligated balances in the supporting appropriation and any appropriations from which the Secretary had authority to transfer funds into that supporting appropriation. Note that the expressed reason for giving DOD this transfer authority and for giving "relief from...[the Anti-Deficiency Act]"¹⁰⁷ was so that DOD could manage the appropriations on a cash flow basis.

However, although GAO acknowledged the authority of the Navy to assume such a liability, it did not concede the authority of the United States to pay such liability in the event it should arise in a deficiency situation. With regard to contractor recovery in the event the "obligational authority" of the Department should be insufficient to pay the termination charges GAO said:

We are not convinced that the cases of Myerle v. United States, 33 Ct.Cl. 1 (1897) and Dougherty v. United States, 18 Ct.Cl. 496 (1883), which were cited in the letter from DOD [in support of the proposition that contractors could recover on a judgment against the United States in a situation where the Government was without appropriated funds to liquidate a contractual debt] would be applied in a situation where the contractor is aware that funds are not being obligated and set aside for liquidation of the contractual obligation...¹⁰⁸

GAO understood the lease arrangement somehow to be operating as an exception to the Anti-Deficiency Act, as far as the agency's authority to enter into it was concerned. But, because no funds were being reserved to fund the liability, GAO was not of the opinion that the contractor could recover in court. It reasoned that since the contractor was on notice of the status of funding, he assumed the risk

of the adequacy thereof.

Fenster and Voltz would add to this argument that the contractor should not be able to recover for the further reason, once again, that the courts would hold that Congress cannot in an appropriation act repeal by implication a section of permanent legislation.¹⁰⁹ The appropriation act in question gave DOD the authority to transfer funds among various appropriations. To understand the implications of this, GAO looked to the legislative history of a piece of similar legislation and concluded that the transfer authority was tantamount to an exception to the Anti-Deficiency Act. Furthermore, this exception was being created without regard for providing contract authority to assume the liability. That is, there was no authority to incur the obligation in advance of an appropriation. There is only authority to transfer already appropriated funds from "unobligated balances" in the accounts of other funded programs.

However, in the case of the SST termination liability, GAO said that Congress' failure to fund the termination liability under those circumstances amounted to congressional recognition of "the obligation of the Government to the contractors."¹¹⁰ This would appear to indicate that the Government had authority to pay the liability in the event the contingency should occur. One can see differences between the situation in 51 Comp. Gen. 598 and the other situations. This ad hoc approach lends itself to nuances among the various situations as they appear. This makes reconciliation among them a difficult exercise. Such an approach also makes it difficult to reconcile a given case with clearly established procedures regarding the legislation of contract

authority.

It should be noted that (except for the problem involving the SST which was funded by a specific appropriation of limited amount¹¹¹) this discussion of the effect of Government inability to fund its termination liability would be regarded by most within the Government as purely hypothetical. The Department's letter to the Comptroller General in 51 Comp. Gen. 598 indicates it would be looking to the total "obligational authority" of the Navy Industrial Fund to liquidate any termination charges arising under the lease. These amounts in question were cited for the GAO at the close of several fiscal years, all in terms of hundreds of millions of dollars.¹¹² The implication is that amounts available would certainly be sufficient to fund any termination liability that might arise. It would only be necessary to reprogram the amounts needed from unobligated balances in other programs. Notice that this justification for not creating a reserve fails to take into account the Anti-Deficiency Act's proscription against advance overobligations.

Similar thinking can be seen regarding Congressional failure to fund termination liability. The implication of the committee's statement regarding 1968 DOD appropriations that it would "cooperate with the Department of Defense in making...funds available"¹¹³ in the event of liability can only be that it would acquiesce in the Department's reprogramming of funds to cover any such liability. So long as there are unobligated amounts in accounts subject to being reprogrammed, the Government could pay any liability arising under a termination clause. The only other possible meaning to give to the

statement is that the Committee would urge Congress to make a special appropriation to liquidate the liability. In either case, this thinking further evidences what Fenster and Voltz discerned: a failure of the Government (this time including Congress) to take seriously the Act's prohibition against obligations in excess of appropriations and its preoccupation with a "cash flow" theory of the Act.¹¹⁴

e. The Effect of the "Multiyear Statute."

The 1981 enactment of the multiyear portions of 10 U.S.C. § 2306¹¹⁵ authorized the assumption by the Government of cancellation or termination liability on multiyear contracts. However, whether or not they provide contract authority so to obligate the Government is subject to the same questions as are presented in the payment provisions of the current indemnity statutes.¹¹⁶ The wording of the multiyear "payment provisions," 10 U.S.C. § 2306(g)(3) and (h)(5), is virtually the same as the payment provisions in most of the present indemnification statutes quoted at Chapter IV.C.1.d. If it does provide contract authority, it is less than forthright in so doing. In commenting on the section of the bill that was to become 10 U.S.C. § 2306(h)(2)(B), the Air Force General Counsel said:

Such an obligation [as cancellation charges] must be funded unless there is specific statutory authority to incur it in advance of appropriation [citing the Anti-Deficiency Act]. Statutory exemptions from these provisions are rare and are not lightly granted since they would involve a substantial deviation from the normal controls on appropriations and expenditures by the government. To provide for such an exception in H.R. 745 we recommend that [the] subsection [in question] be revised as follows:

A contract described in paragraph (1) may contain a clause setting forth a cancellation ceiling which may permit reimbursement of unrecovered recurring and

nonrecurring contractor costs associated with the production of items to be delivered under the contract. Notwithstanding the provisions of...[the Anti-Deficiency Act] a cancellation ceiling as provided for in this subsection need not be recorded as an obligation, unless the cancellation charge becomes payable.¹¹⁷

Obviously, the recommendation was not followed. This recommendation, however, evidences that even within the Government there was doubt as to whether or not contract authority had been created by this statute. Nevertheless, the implication of the subsection providing that, payment may be made from "appropriations currently available for procurement of the type of property concerned...or funds appropriated for those payments"¹¹⁸ is that payments are not required to be made from a reservation of contract funds. It further indicates that reprogramming funds from unobligated balances in "appropriations currently available for procurement of the type of property concerned" is an acceptable method of financing termination liability in multiyear contracting.

It is curious, however, that enactment of 10 U.S.C. § 2306(h)(5), the payment provision, may have been motivated not by Anti-Deficiency Act concerns, but by the "bona fide needs" doctrine. Very briefly, the bona fide needs rule is a fundamental principle of Federal appropriations law which states, "A fiscal year appropriation may be obligated only to meet a legitimate, or bona fide, need arising in the fiscal year for which the appropriation was made."¹¹⁹ The question with regard to paying the termination liability on the previous year's contract with the current year's appropriations is whether or not that termination charge meets a bona fide need of the current year.

10 U.S.C. § 2306(h)(5) makes it clear that termination charges from prior year's contracts may legitimately be paid with current year's funds. In commenting on that section of the law, Air Force General Counsel noted, "[10 U.S.C. § 2306(h)(5)] concerning the availability of funds for payment of cancellation charges clarifies a potentially arguable point of fiscal law relating to which fiscal year's appropriations may be used."¹²⁰

However, that Congress understands that DOD has authority to enter into contingent unfunded obligations for cancellation can be seen by reference to P.L. 97-377, the joint resolution providing continuing appropriations for 1983.¹²¹ There Congress provided:

None of the funds in this Act shall be available to execute a multiyear contract which employs any economic order quantity procurement or which includes an unfunded contingent liability in excess of \$20,000,000 unless the Committees on Appropriations have been notified in advance: Provided, That no part of any appropriation contained in this Act shall be available to initiate multiyear procurement contracts for major weapons systems except as specifically provided herein. (Emphasis added.)¹²²

f. Conclusion.

Thus, it appears that as far as Congress is concerned, DOD has authority to assume unfunded cancellation liabilities. In light of the fact that GAO did not question the legality of so doing in 51 Comp. Gen. 497 or in B-159141, it is not likely that it would do so in the face of 10 U.S.C. § 2306(h)(5). Whether a court faced with the problem would conclude that 10 U.S.C. § 2306(h)(5) amounts to repeal by implication of the Anti-Deficiency Act, decide that the multiyear statute provided contract authority, or reach some other conclusion

remains problematical. As the executive branch is acting in concert with Congress in these matters, however, what the courts would do with the problem also will most likely remain hypothetical.

2. The Special Termination Costs Clause.

a. Description of the Clause.

The Special Termination Costs clause is a DOD clause for use in multiyear contracts that are "incrementally funded."¹²³ In incremental funding the Government allots to the contract and obligates only a portion of the amount necessary to complete the work. The concept has been summarized as follows:

Funds are not available at the time of contract award to complete a fiscal year's quantity of end items in a finished, military useable form. Future year appropriations are required in order to complete the items or tasks. Incremental funding is commonly used for [research, development, test and evaluation] programs.¹²⁴

As more funds become available to the buying activity, more funds may be allotted to the contract and recorded as an obligation.¹²⁵ This process may continue until the contract becomes fully funded. The contractor is aware of the limitation of the Government's liability on such a contract through the operation of either the Limitation of Cost or Limitation of Funds clause.¹²⁶ Those clauses have been described above.¹²⁷ But, very briefly, they tell the contractor how much of the total estimated cost of the effort is presently allocated and available for payment. They further state that the contractor must monitor his costs and apprise the contracting officer when he comes within a certain percentage of the allotted amount. The contracting officer then must allot more money to the contract or the contractor

has the right to treat the contract as terminated. In any event, these clauses limit the Government's obligation to reimburse contractor costs to the estimated amount of cost set forth in the schedule of the contract. This limit is the maximum Government obligation whether the contractor's costs are incurred in the performance of the contract or as a result of termination.

The effect of these clauses is to create a termination liability reserve. In monitoring his costs, the contractor must consider a hedge against the possibility of termination. The Special Termination Costs clause segregates certain agreed costs, defined to be special termination costs, and provides that in the event of termination, the contractor would be reimbursed these costs "[n]otwithstanding the Limitation of Cost/Limitation of Funds clause" of the contract. Thus, the clause excuses special termination costs from the operation of the Limitation of Cost or Limitation of Funds clause much like the Insurance--Liability to Third Persons clause excuses its indemnity provisions from the operation of those clauses. (But, the Special Termination Costs clause does so without a limitation of liability provision.)

The clause is used most frequently in research, development, test and evaluation (RDT&E) contracts. The reasons for a different approach in RDT&E contracting to that used in other multiyear contracting are that, 1) unlike the procurement appropriations of DOD, RDT&E appropriations are not subject to the "full funding" policy of DOD,¹²⁸ and 2) RDT&E contracting is not covered by the multiyear procurement statute.

In relevant part the clause provides:

Notwithstanding the Limitation of Cost/Limitation of Funds clause of this contract, the Contractor shall not include in his estimate of costs incurred or to be incurred, any amount for special termination costs, as herein defined, to which the Contractor may be entitled in the event this contract is terminated for the convenience of the Government. The Contractor agrees to perform this contract in such a manner that his claim for such special termination costs will not exceed \$..... The Government shall have no obligation to pay the Contractor any amount for the special termination costs in excess of this amount. Special termination costs are defined as costs only in the following categories:

- (1) severance pay as provided in FAR 31.205-6(g);
- (2) reasonable costs continuing after termination as provided in FAR 31.205-42(b);
- (3) settlement of expenses as provided in FAR 31.205-42(g);
- (4) costs of turn of field personnel from sites as provided in FAR 31.205-35 and FAR 31.205-46(c); and
- (5) costs in categories (1), (2), (3), and (4) above to which subcontractors may be entitled in the event of termination.

Therefore, in essence, the clause provides for recurring costs of termination in incrementally funded contracts what the cancellation ceiling provides for both nonrecurring and recurring costs in other multiyear contracting. All of the above categories of costs except (4) are within the definition of recurring costs.¹³⁰

b. The Special Termination Costs Clause and the Anti-Deficiency Act.

The contingent liabilities for which the Government is obligated under the Special Termination Costs clause are the "special termination costs" as defined by the contract up to the "not to exceed" amount stated in the clause. DOD FAR Supplement 49.7003(a)(3) states that the clause may be used when "adequate resources are available within existing appropriated amounts to cover the contingent reserved liability for special termination costs in the event of contract termination." According to 54 Comp. Gen. 824, the Anti-Deficiency Act requires that the "not to exceed" amount should be administratively reserved. This is the only way to be certain that "adequate resources are available." In accordance with DOD 7220.9-M Chapter 25 C.6.,¹³¹ this is not done. That special termination costs are considered in the same manner as are other contingent termination liabilities can be seen by reference to AFR 170-13 Section D 26. c. which states, "Commitments are not recorded for special termination cost clauses or contingent termination liabilities. Obligations are recorded per AFR 170-8 when the action to terminate is taken." This appears to be a violation of the Anti-Deficiency Act.

c. The History of the Clause.

That such a clause could come into being can be understood by the fact that it had its genesis within the Air Force as early as 1960.¹³² That predates the 1975 decision of 54 Comp. Gen. 824. At that time there stood the rule of 42 Comp. Gen. 702, to the effect that no reserve was required if the chance of the contingency coming about was remote.¹³³ In spite of that rule, Air Force General Counsel took the position that a reserve was required. That position and the further history of the clause have been recorded and traced as follows:

On January 31, 1968, in response to a request for an opinion whether a Special Termination Cost clause contained in an Air Force contract might create an over obligation of funds, [the Air Force General Counsel's] office expressed the opinion that it could because the clause included an obligation to pay costs upon termination that would have been incurred had there been no termination. Such costs included material and labor costs for work in process, subcontract costs, and profit, incurred but not yet paid. These costs which might be paid upon termination would have been paid if the contract continued to completion and were said not represent a contingent liability, but rather an actual obligation for which funds must be allotted to the contract. If funds were not allotted, [Air Force General Counsel] concluded that there would be a violation of [the Anti-Deficiency Act].

[Air Force General counsel] stated that there was only a very limited category of costs for which funds need not be allotted. These are costs which are incurred only in the event of termination but which would otherwise not be incurred--i.e., special termination costs. [He] stated that special termination costs could be accounted for by administratively reserving funds until termination actually occurred, because such costs would be entirely contingent upon termination and none of the costs would have to be paid if the contract was not terminated....

In February 1968, the Air Force Director of the Budget indicated that, in fact, there existed no specific administrative reservation of funds for special termination costs, and furthermore that one was not considered necessary because, if additional funds were required on a contract in the event of

termination, "adequate unobligated funds would be available within the applicable appropriations, even though reprogramming from other approved programs might be necessary."

The Air Force Budget Director's position apparently was based on comments in the House Appropriations Committee Report (H.R. Rep. No. 349) on the 1968 DOD Appropriations Act [quoted above¹³⁴] concerning the funding of cancellation charges on multi-year contracts. Congress indicated it was not necessary to budget for such costs and deleted funding for them....

In January 1970 the Special Termination Costs clause [in essentially the same form as it is today] was approved for inclusion in the [Armed Services Procurement Regulation] for use with incrementally funded cost¹³⁵ reimbursement and fixed price incentive contracts.

Thus, apparently on the strength of the above referenced Committee Report and the Appropriation Act, these termination liabilities were not being funded. It should be noted that the Committee Report above referenced, and the appropriations in question concerned the procurement appropriations, not the RDT&E appropriations. In that report, the committee was commenting on the reasons for deleting funds for termination reserves in the procurement appropriations. In contracts using the Special Termination Costs clause, there was no funding of the termination liabilities named in the clause. Therefore, there would have been no need for Congress to consider deleting funds for such purposes.

d. Congressional "Policy" and the Special Termination Costs Clause.

In 1973 a Congressional Committee did sanction the use of the Special Termination Costs Clause and the practice of not funding the contingent liability created thereby. In its report on the 1974 DOD Appropriations Act, the Senate Committee on Armed Services stated:

Under the standard Armed Services Procurement Regulation (ASPR) clauses used in an incrementally funded cost reimbursement type research and development contract, the government is not obligated to reimburse the contractor for costs incurred in excess of the total amount of funds allotted to the contract, including costs allowable under the termination clause. This induces the contractor to monitor the government's liability to make sure that it is not exceeded, and to assure that costs the contractor would incur in the event of termination are recoverable within the total amount of the Government's liability. This may result, in effect, in contractor's limiting their costs to provide a reserve to cover termination costs should termination occur. Such action could lead to tying up of considerable amounts of money for potential termination charges and prevent the more effective and timely utilization of appropriations for research and development.

Section 8-712 of the ASPR, however, permits the use of a Special Termination Costs Clause for major research and development contracts in excess of \$25 million. This requires the government to pay certain termination costs in a stated amount in excess of the amount otherwise allotted to the contract. The use of this clause enables a contractor to more fully utilize the funds allotted to the contract without the need to provide for a reserve against possible termination.

The Special Termination Costs Clause has not been widely used. The Air Force has used it in a number of their contracts, and the committee is not aware that it has been used by either the Army or the Navy. Although funds are not obligated when the Special Termination Costs Clause is used, in order to assure that the provisions of the Anti-Deficiency Act are not violated in the event of termination, the departments must assure that funds are available to cover this potential liability if termination occurs. However, in view of the unobligated balances available in the RDT&E appropriations, and the relatively small risk of termination of any major contracts that could contain the clause, the risks of not having sufficient funds to

meet these potential obligations are minimal. Accordingly, the committee suggests that greater use of the clause be made by all the military departments.

The selective use of this clause on a case-by-case basis would be considered prudent business practice, and the benefits to be derived far outweigh any potential risks which would in any event be manageable.¹³⁶

Thus, Congressional policy with regard to the use of the Special Termination Costs clause mimics its policy with regard to cancellation charges on other multiyear contracting. The Committee recognized the Anti Deficiency Act problem with regard to special termination costs, but stated its endorsement for the practice of not funding them, nevertheless.

e. The Legal and Practical Effects of No Multiyear Statute Applicable to RDT&E Contracting.

The discussion of the legal and practical effects of the lack of funding for Special Termination Clause liabilities could simply parrot what was said about the failure to fund cancellation ceilings above except for the fact that the practice continues without benefit of statutory authority. 10 U.S.C. § 2306 provides statutory authority for multiyear contracting regarding the purchase of property¹³⁷ and certain services, not including RDT&E.¹³⁸ Therefore, the only authority the Government has for not adhering to the Anti-Deficiency Act consists in the two above quoted Committee Reports.

Furthermore, the only Congressional statement on a source of funds for these unfunded contingent liabilities is the Senate Committee Report which would look to "the unobligated balances available in the RDT&E appropriations."¹³⁹ Possibly the argument can be made that by

being made aware of this practice and choosing not to appropriate funds on account thereof, Congress agrees with the Senate Committee's recommendation. This would be similar to the Congress' decision not to fund the requested cancellation ceilings as a result of the 1968 House Committee Report and the decision regarding the SST termination liability.

Therefore, the legal effect of this practice remains as problematical as does that of not funding cancellation ceilings on other multiyear contracting. Moreover, it has the added twists that Congress has never considered deleting funds proposed to fund a special termination costs termination reserve, and there is no statute lending further legitimacy to the failure to fund these potential liabilities.

As a practical matter, however, given that Congress evidently won't object to DOD reprogramming amounts from its unobligated balances to fund these liabilities, and given continued Congressional acquiescence in the practice of not funding the amounts in question, it may be unlikely that a court would ever have to face the unpleasant task of having to decide upon the legality of these practices. It may also remain an academic exercise whether the Government or the contractor must bear the loss in the event these practices were determined to violate the Anti-Deficiency Act.

3. Conclusion.

As a practical matter, it may be hard to engender excitement over the apparent Congressional participation in and of itself in these funding practices, which otherwise would be unallowable as violations of the Anti-Deficiency Act. However, the fact that the legal aspects of the matter are so lightly regarded by Congress ought to make both the agencies and the contractors take stock. If the proscriptions of the Anti-Deficiency Act are not important in these instances, then when are they or ought they to be? There can be little wonder about the observations cited in Chapter II about repeated violations and a general failure to take seriously the Anti-Deficiency Act. The practices discussed above make good business sense, and the above committee reports indicate that Congress appreciates this fact. But, Congress has the option of dealing with the Anti-Deficiency Act head on, not just selectively ignoring it, or "repealing it by implication." Also, when it does provide express statutory authority, Congress could do so without a clear provision for the recognized substitute for an appropriation, contract authority. There is no reason why an agency should have to question GAO about its authority in light of the Anti-Deficiency Act. Nor should GAO have to find an "authorized by law" exception to the Act by implication of an appropriation bill. Congress could clearly state in law which termination liabilities it chooses to assume without funding, and that it chooses so to do without regard to the Anti-Deficiency Act. Such an approach would be one step toward making clear that the Anti-Deficiency Act is to be taken seriously by all concerned in Government contracting.

VI

SUMMARY AND CONCLUSION

What is sauce for the goose is sauce for the gander.
-Tom Brown

All of the foregoing only reinforces the conclusions of other writers whose topics went beyond mere description of the Anti-Deficiency Act. Guidance is "erratic" and "inconsistent."¹ Both Congress and the agencies seem to have adopted a "cash flow" approach to the Act, at the expense of the Act's prohibition of obligations in advance of appropriations.² The sins of Anti-Deficiency Act violations are preached to the agencies in the field,³ but the most glaring, expensive, and seemingly careless violations appear to go unpunished.⁴ Generally, only the taxpayers, whose money is used to pay deficiency claims, seem to bear the responsibility for violations of the Act.

Contingent liability situations have been demonstrated to be one possibly major area where this duplicity regarding the Anti-Deficiency Act is evident. No participants in Government contracting are free from complicity in efforts either to ignore or distort the implications of the Anti-Deficiency Act. Even the private sector must take some responsibility. For example, the Public Contracts Law Section's letter⁵ to GAO concerning the decision on the Insurance--Liability to Third Persons clause made no attempt to rationalize the clause with the Act or consider the funding problem. The agencies are the ones who primarily have not "learned to live with" the Anti-Deficiency Act and repeatedly report violations of it.⁶ But, the author believes that

primary responsibility for the myriad problems rooted in the Anti-Deficiency Act, especially as they involve contingent liabilities, lies in three places. They are the GAO, Congress, and the Anti-Deficiency Act, itself.

The GAO's contribution to the problems has been an inconsistent application of the Act over a period of forty some years. If the GAO opinions cited herein were set up in chronological order, the author believes that three phenomena would be evident. First of all, there is, as GAO so often repeats, a consistent statement of the Anti-Deficiency Act rule applicable to contingent liabilities. In paraphrase it is that the accounting officers of the United States have consistently held that, unless otherwise authorized by law, a provision in a contract which subjects the United States to an indefinite and uncertain liability contravenes the Anti-Deficiency Act and the Adequacy of Appropriations Act. There can be no doubt that this has consistently been stated to be the rule, whenever a rule was stated.

The second phenomenon is a growing awareness over time on the part of GAO of the implications of that consistently stated rule. One can see a complete reversal in the thinking of GAO from 20 Comp. Gen. 632 (1941) to 54 Comp. Gen. 824 (1975) and 62 Comp. Gen. 361 (1983). In the former opinion, assuming certain contingent risks was the "essence of cost contracting." In the first of the latter two, absent express statutory authority, assumption of a contingent liability required either a limitation of liability or an administrative reservation of funds. Then, in 62 Comp. Gen. 361 any authority absent "express statutory authority" was questioned.

The third phenomenon is a trend away from deciding contingent liability issues according to accepted accounting practice to deciding them on the basis of the legal implications of the Anti-Deficiency Act. Especially in 34 Comp. Gen. 418, 37 Comp. Gen. 691, and 42 Comp. Gen. 708 one can see the opinions being decided upon the basis of accounting procedures. But, without ever saying so, GAO apparently began to realize that the accounting practices did not answer the questions of federal fiscal law.

This third phenomenon is a necessary consequence of the second. That is, as GAO gradually reversed itself over the period, the accounting rules would necessarily have to be affected by the growing awareness of the implications of the law.

The fact that such focusing and reversal took place over such a long period of time is one reason why there has been so much confusion in this particular area. This has contributed to an environment in which everyone could state the rule, but nobody knew for certain what it meant in any given situation. The agencies could not be certain whether the accounting practice or the legal rule would dominate.

Secondly, Congress is to be blamed for adding confusion to the area. In several instances, Congress has acknowledged the fact that it doesn't make sense to fund contingency reserves for various contingent liabilities. But, it has not in all cases faced up to the requirements of the Anti-Deficiency Act with a clear statement of "contract authority." Congress is aware of the "unless authorized by law" exception to the Anti-Deficiency Act. But, of all the contingent liabilities considered herein, only 42 U.S.C. § 2210 (the

Price-Anderson Act), 50 U.S.C. § 1431, and the pending "Contractor Liability and Indemnification Act" state that the assumption of risks authorized by the legislation may be done so without regard to an appropriation therefor or without regard to the Anti-Deficiency Act.

In the other instances, the requirements of fiscal law have been ignored, rationalized by an improper understanding of the Government's self-insurance policy, or dealt with in a manner whose substitute for an appropriation was not an unequivocal enactment of contract authority. Instead of functioning according to such terms of art, Congress has adopted the agencies' "cash flow" approach to the Anti-Deficiency Act. In several statutes, and in the various committee reports and their resulting appropriation acts, Congress has stated where dollars for several contingent risks might come from in the event of liability--nothing else. It has adopted the agencies' solution of reprogramming to provide cash, in the event cash should be necessary, without ever considering the implications of the Anti-Deficiency Act's prohibition against obligations in advance of appropriations.

In 62 Comp. Gen. 361 GAO said that Congress' intent could be frustrated if the agencies would essentially reprogram funds to liquidate a contingent liability in the event it should materialize. But, in the several statutes and committee reports discussed, Congress appears to be inviting its original intent in making certain appropriations to be frustrated.

One has to question why Congress chose to authorize the assumption of certain contingent obligations with the understanding that they might be liquidated with money from other programs. It is no more

difficult to say that they may be assumed without regard to the Anti-Deficiency Act. Formerly, GAO said an administrative reservation of funds was not necessary when the contingency was remote.⁷ Now, in many instances Congress seems to be saying the converse of that: it is not necessary to reserve funds when the agency has access to a large unobligated balance. One approach is as wanting as the other when it comes to the Anti-Deficiency Act's proscriptions against obligations in advance appropriations.

It appears that Congress intends to fund these various contingent liabilities, and to do so with no loss to other programs whose appropriations it has made available to pay the contingent obligations. Therefore, it appears that nothing is gained by any of the procedures which function with something other than an appropriation or clearly stated "contract authority."

The same results could be achieved by enacting a permanent indefinite appropriation (maintained at an appropriate "cash flow" level) to liquidate whatever contingent risks Congress chooses to sanction. Alternatively authorizing legislation could state that the obligation it contemplates could be assumed without regard to an appropriation therefor. Such legislation could also set guidelines for the agencies' exercise of that authority. All this could be done without raising Anti-Deficiency Act questions. Such is the approach of the pending "Contractor Liability and Indemnification Act."

With enactment of that legislation, the above objections would be answered. However, the multiyear statute would not be affected by change in the indemnification area. The new forms of express statutory

authority and such "implied contract authority" as may be derived from the committee reports and appropriation acts appear to be firmly entrenched in the area of multiyear contracting. One may hope that questions about whether or not these statutes provide not only authority to assume the risk, but contract authority as well, may be specifically addressed by Congress in the same manner as contemplated by the pending indemnity legislation.

Finally, the Act itself is a cause of problems involving contingent liabilities. In the Federal Government, a contingent liability cannot be considered a simple bookkeeping matter. Actual dollars must be identified to support the obligation. Without statutory authority, the Act requires a limitation of liability or an administrative reservation of funds. If the limitation of liability may be practically discounted as making recovery into a game of chance, then a reservation of funds is the only remaining alternative. No one would argue that it makes any sense to set aside funds for a particular risk without any reasonable expectation that the risk will materialize into an absolute liability. This is all the more true considering that what is involved are not investments of an insurance company or a business, but taxpayer appropriations. On the other hand, no one would argue that it is prudent practice, either in the commercial world or in Government, to obligate oneself contractually without considering one's ability to absorb the costs and potential risks involved.

This is the dilemma created by federal appropriations law. The legal requirement is for complete fund availability as a requisite part of the authority to obligate the Government. This requirement does not

allow for flexibility in assuming cost risks which, in prudent business practice, are better left dependent upon the happening of some contingency. While the Act allows for an exception to the funding requirement, neither Congress nor the agencies have been thoroughly rigorous in using it regarding such business risks.

Once again, the "Contractor Liability and Indemnification Act" may be a first step toward using the exception in other areas. This may come about if Congress realizes that the indemnity act merely concerns a contract pricing factor, and that there may be other pricing factors which could be better handled similarly.

Secondly, the Act is its own worst enemy in that it doesn't really lend itself to enforcement. With regard to the penal sections, the agencies can hardly be expected to seek prosecution of their own actions. And, otherwise Congress seems to have acquiesced in the belief that generally contractors should not have to absorb losses caused by violations. Contractors have come to expect Congress to fund these deficiencies. In fact, GAO is the most important champion of the Act. But, as a practical matter, its authority is limited to stating beforehand whether or not a proposed course of action would violate the Act.

All of this has left the Act at the mercy of the desires of Congress and the agencies to make the best use of appropriated dollars, and of the contractors, who, naturally enough, want as much protection as possible. Congress and the agencies evidence an affinity for good business and accounting practice in spite of the Anti-Deficiency Act. This is so even though the accounting officers have lately said that,

in regard to contingent liabilities, unless authorized by law, the Anti-Deficiency Act makes this a practical impossibility.

Thus, consistency is lacking throughout. This is true even though it is regarded as virtue by both lawyers and accountants. Once in pursuit of the practical consistency sought by accounting, GAO now seems intent on the logical consistency demanded by the law. As they have in the past, practicalities will continue to present obstacles to this pursuit, and, as Thoreau observed, expediency may have its way.

If it does so, the Anti-Deficiency Act will continue to be mainly an object of criticism and a source of confusion for all involved in Government contracting. Unlike his fellow authors, Hopkins and Nutt, the present writer is not convinced that the solution lies in a better understanding of the Act through education and better implementing regulations. Nor does it lie in better cooperation among contracting officials, accountants, and lawyers. A more basic and thoroughgoing effort is needed. This would require cooperation between the Congress and the agencies. They should join in an effort to discern why these Anti-Deficiency Act problems persist, how the Act is in some cases an impediment to sound contracting practices, and how these problems may be dealt with, without sacrificing the important principles of fiscal law embodied in the Act. Whether or not such an effort may be undertaken will not depend upon how important consistency is for its own sake. Rather, it will depend upon how important this consistency is, or may become, as an expedient to getting the job of Government contracting done--as a practical matter.

FOOTNOTES

Citation Convention

There is no uniformly prescribed citation to the Comptroller General's Decisions. For purposes of this paper, the author has adopted the following convention: All opinions published in the Decisions of the Comptroller General of the United States (Comp. Gen.) are cited thereto. All opinions not published therein are cited by their docket number, "B" number. Dates are specified at the first textual reference, where otherwise helpful, and in the footnotes. If the matter is published in Comptroller General's Procurement Decisions (CPD), that citation is given at the initial footnote reference.

CHAPTER I

1. Black's Law Dictionary 392 (Rev. 4th ed. 1968).
2. AF Regulation 170-13, Accounting for Commitments, ¶ 26 (1982).
3. R. Nash & J. Cibinic, Federal Procurement Law, 1010 (3d. ed. 1977, 1980) [hereinafter cited as Nash & Cibinic].
4. See generally GAO, Principles of Federal Appropriations Law Chapter 3 C.(9) (1982) [hereinafter cited as Federal Appropriations Law].
5. FAR 52.245-4, 52.245-5, 52.245-7, 52.245-10, 52.245-11 [Note: All citations herein to FAR are to FAR April 1984].
6. DOD FAR Supplement 52.228-7001 [Note: All citations herein to DOD FAR Supplement are to the April 1984 edition].
7. Federal Appropriations Law, supra note 4, at Chapter 3 C. (9)(a).
8. 18 Comp. Gen. 285 (1938).
9. FAR 31.205-19.
10. 15 Comp. Dec. 405, 407 (1909).
11. See Chapter V.D.

12. Hopkins & Nutt, The Anti-Deficiency Act (Revised Statutes 3679): and Funding Federal Contracts: An Analysis, 80 Mil. L. Rev. 51, 134 (1978).

CHAPTER II

1. AF Pamphlet 170-19, Avoiding Violations of the Anti-Deficiency Act (RS 3679), 1 (1982).

2. U.S. Const. art. I, § 8, cl. 1.

3. U.S. Const. art. I, § 9, cl. 1.

4. Act of July 12, 1870, ch. 251, § 7, 16 Stat. 251.

5. Hopkins & Nutt, supra ch. I note 12, at 59-60.

6. Federal Appropriations Law, supra ch. I note 4, at 5-7.

7. See Hopkins & Nutt, supra ch. I note 12, at 56.

8. L. Wilmerding, Jr., The Spending Power, A History of Efforts of Congress to Control Expenditure 73, 213 (1943).

9. Hopkins & Nutt, supra ch. I note 12, at 57.

10. Act of Feb. 12, 1868, ch. 8, § 2, 15 Stat. 35, 36.

11. Act of July 12, 1870, supra note 4.

12. Act of Sept. 6, 1950, ch. 896, § 1211, 64 Stat. 765.

13. L. Fisher, Presidential Spending Power 235-6 (1975).

14. Hopkins & Nutt, supra ch. I note 12, at 55.

15. AF Pamphlet 170-19, supra note 1, at 9.

16. Fenster & Voltz, The Antideficiency Act: Constitutional Control Gone Astray, 11 Pub. Cont. L. J. 155, 157 (1979).

17. See generally, 55 Comp. Gen. 768 (1976).

18. Spriggs, The Anti-Deficiency Act Comes to Life in U.S. Government Contracting, 10 Nat'l. Cont. Management J. 33, 33 (1976-7).

19. Id. at 42.
20. Fenster & Voltz, supra note 16, at 213-4.
21. Hopkins & Nutt, supra ch. I note 12, at 134.
22. Fenster & Voltz, supra note 16, at 158.
23. Efros, Statutory Restrictions on Funding of Government Contracts, 10 Pub. Cont. L. J. 254 (1978); Fenster & Voltz, supra note 16; Hopkins & Nutt, supra ch. I note 12; Spriggs, supra note 18.
24. 31 U.S.C. § 1341(a)(1).
25. See e.g., OMB Cir. A-34, Instructions on Budget Execution (July 15, 1976); DOD-D 7200.1, Administrative Control of Appropriations (Nov. 15, 1978).
26. See e.g., AF Regulation 177-16, Administrative Control of Appropriations (1980).
27. Fenster & Voltz, supra note 16, at 160-2, 218-20.
28. L. Wilmerding, Jr., supra note 8, at 138.
29. Fenster & Voltz, supra note 16, at 161,
30. Id. at 194-203.
31. Id. at 199.
32. 42 Comp. Gen. 708 at 710 (1963). "Reprogramming" and its related concept, "transfer" have been described as follows in Federal Appropriations Law, supra ch. I note 4, at 2-28, 2-29:

Reprogramming is the utilization of funds in an appropriation account for purposes other than those contemplated at the time of appropriation; in other words, the shifting of funds from one object to another within an appropriation. Transfer is the shifting of funds between appropriations....

Transfer is prohibited without statutory authority....

Reprogramming is usually a non-statutory arrangement. This means that there is no general

statutory provision either authorizing or prohibiting it, and it has evolved largely in the form of informal (i.e., non-statutory) agreements between various agencies and their congressional oversight committees. Thus, as a matter of law, an agency is free to reprogram unobligated funds as long as the expenditures are within the general purpose of the appropriation and are not in violation of any other specific limitation or otherwise prohibited.

33. 54 Comp. Gen. 824 at 827 (1975).
34. 31 U.S.C. § 1517.
35. Federal Appropriations Law, supra ch. I note 4, at 5-40.
36. 31 U.S.C. § 665 (1946 ed.) (R.S. § 3679; Mar. 3, 1905, ch. 1484, § 4, 33 Stat. 1257; Feb. 27, 1906, ch. 510, § 3 34 Stat. 48 amended by Act of Sept. 6, 1950, c. 896, ch. XII, § 1211, 64 Stat. 756.)
37. Id.
38. John J. Judy, DOD OAGC (Logistics), Memorandum for Mr. James Brannen, Director Defense Acquisition Regulatory Systems/DARS (June 29, 1982).
39. 62 Comp. Gen. 361 at 367, 83-1 CPD ¶ 501 (1983).
40. Id. at 367.
41. B-206625, July 27, 1982.
42. Federal Appropriations Law, supra ch. I note 4, at 5-40.
43. 31 U.S.C. § 1341(a)(1).
44. U.S. Const. art. I, § 9, cl. 1.
45. Federal Appropriations Law, supra ch. I note 4, at 5-25.
46. The Floyd Acceptances, 74 U.S. 666 (1869).
47. OMB Cir. A-34, supra note 25, at Part II 21.1.
48. Fenster & Voltz, supra note 16, at 180-1.
49. Federal Appropriations Law, supra ch. I note 4, at 5-11, 5-12.

50. Chapter V.C.
51. Chapter V.D.
52. Fenster & Voltz, supra note 16, at 181.
53. Id. at 181.
54. 55 Comp. Gen. 768 (1976).
55. 31 U.S.C. § 1432.
56. Fenster & Voltz, supra note 16, at 215.
57. The Navy argued that the contract, once legal, remains forever legal, and that the contractor could recover amounts due in the Court of Claims, id. at 215-6.
58. Id. at 214.
59. See id. at Chapter V.
60. 35 Comp. Gen. 85, 87 (1955).
61. 20 Comp. Gen. 632, 636-7 (1941).
62. See discussion at Chapter V.A.
63. 62 Comp. Gen. 361, 363-4 (1983). The Comptroller General's attempted rationalization is not convincing. GAO said at 65 Comp. Gen. 361, 366-7:

In [20 Comp. Gen. 632 and a similar case, 21 Comp. Gen. 149 (1941)], the only question involved reimbursement to a contractor for damage to his own property which had been leased by the Government. In the first case, the damage to some heavy equipment was caused by the Government's own negligence; in the second, the damage was attributable to the negligence of the contractor's employees. In neither case was damage to third parties involved. The maximum amount of any potential property damage was therefore readily ascertainable; i.e., even if the equipment was totally destroyed, the maximum liability would be the value of the equipment.

The position failed to consider the obligations assumed in 20 Comp.

Gen 632. It may have been in that the voucher in question was for payment due to damage to the contractor's equipment. But, the contractual clause pursuant to which payment was made is quoted at 20 Comp. Gen. 632, 635:

ARTICLE II. Cost of the work.

REIMBURSEMENT FOR CONTRACTOR'S EXPENDITURES

1. The contractor shall be reimbursed...for...the following items:

* * *

(k) Losses and expenses, not compensated by insurance or otherwise (including settlements made with the written consent of the contracting officer), actually sustained by the contractor in connection with the work and found and certified by the contracting officer to be just and reasonable. (Emphasis added.)

The language "including settlements" implies that the clause contemplated third party liability. And, as GAO has repeatedly pointed out, it is the obligation itself (definite or contingent), not only payment, which is the violation of the Act. Furthermore, nothing indicates that the Army either had or was apprised of a legal requirement to establish an administrative reservation of funds (commitment) equal to the total value of the contractor's property for which it may become liable. In fact, GAO didn't perceive that the logic of its position required the establishment of such a reserve until it reversed itself in that regard in 54 Comp. Gen. 824 (1975).

One might also question the practicality of GAO's statement that the maximum amount of Government liability was "readily ascertainable" by simply totaling up the value of all the contractor's property. This

simply assumes far too much. GAO may also be suspect for its refusal to see a "clash" between 15 Comp. Gen. 405, and subsequent cases following it on the one hand, and 20 Comp. Gen. 632, on the other. Responding to the American Bar Association Public Contracts Law Section's assertion of such a clash, GAO said at 62 Comp. Gen. 361, 364-5:

[T]here is no clash that we can discern. Except for the 1980 utility case [59 Comp. Gen. 705],...the accounting officers of the Government have never sanctioned the incurring of an obligation for an open ended indemnity in the absence of statutory authority to the contrary.

GAO didn't realize or admit what it had done in 20 Comp. Gen. 632, nor did it admit that prior to 54 Comp. Gen. 824 it had sanctioned fixed indemnity obligations for which no funds had been identified. The issue would have been better served by an admission from GAO that much of what went on in 20 Comp. Gen. 632 and other cases has been lost to history, that everyone has become more sophisticated about the implications of the Anti-Deficiency Act, and that insofar as 20 Comp. Gen. 632 or any other opinions that could be mustered conflicting with the Comptroller General's now reiterated opinion, they would no longer be followed.

It is a moot point because operationally the results are the same. It doesn't matter if GAO "overrules" 20 Comp. Gen. 632 or rationalizes it into a tenuous consistency with 15 Comp. Dec. 405, et seq. Its present position, at least with regard to the Insurance--Liability to Third Persons clause, is clear. What is unfortunate is the lack of an admission that in 1941 GAO could not identify an indefinite contingent obligation and deal with it accordingly.

64. 15 Comp. Dec. 405, 407 (1909).

65. California-Public Utilities Co. v. United States, 194 Ct.Cl. 703, (1971).
66. Id. at 715.
67. Federal Appropriations Law, supra ch. I note 4, at 6-49.

CHAPTER III

1. See e.g., B-201072, May 3, 1982.
2. Federal Appropriations Law, supra ch. I note 4, at 6-44.
3. 18 Comp. Gen. 285, 295 (1938).
4. Chapter II.C.3.
5. Chapter IV.C.
6. 6 Comp. Gen. 619, 621 (1927).
7. Federal Appropriations Law, supra ch. I note 4, at 3-13, 3-14.
8. Id. at 3-13.
9. 194 Ct.Cl. at 715-6.
10. 18 Comp. Gen. 285, 298 (1938).
11. FAR 31.205-19.
12. 59 Comp. Gen. 369, 374 (1980).
13. Id. at 374.
14. Nash & Cibinic, supra ch. I note 3 at 4.
15. B-137976, Dec. 4, 1958.
16. Id.
17. Federal Appropriations Law, supra ch. I note 4, at 6-41.
18. 35 Comp. Gen. 85, 87 (1955).
19. 48 Comp. Gen. 361, 363-4.
20. Id. at 365.

21. Federal Appropriations Law, supra ch. I note 4, at 5-25.
22. 35 Comp. Gen. 85 (1955).
23. See e.g., 60 Comp. Gen. 584 (1981), 81-2 CPD ¶ 28.
24. FAR 52-228-7(d).
25. B-206626, July 27, 1982.
26. 62 Comp. Gen. 361, 367-8 (1983).
27. Federal Appropriations Law, supra ch. I note 4, at 6-50.
28. 54 Comp. Gen. 824 (1975).
29. See Chapter V.D.
30. The DOD Special Termination Costs clause is an example of an agency's desire not to fund such a liability. See Chapter V.D.2.
31. 62 Comp. Gen. 361, 367 (1983).
32. Assistant Attorney General, Department of Justice Memorandum Re: Statutory authority of Defense agencies to indemnify their contractors against uninsurable risks, 8 (Aug. 11, 1967) [hereinafter cited as DOJ Memo].
33. Id. at 3.
34. But see Chapter V.D.2. regarding the DOD Special Termination Costs clause.
35. FAR 28.311-2.
36. See DAR Case file 82-72.
37. H.R. 4199, 98th Cong. 1st Sess. (1983); S. 1839, 98th Cong. 1st Sess. (1983).
38. 54 Comp. Gen. 824 (1975), 62 Comp. Gen. 361, 365 (1983).

CHAPTER IV

1. See e.g., 62 Comp. Gen. 361, 365 (1983), "The line of decisions applying this general principle stretches, unbroken, right up to the May 3 [1982] decision at issue [B-201072]." (Citations omitted.)
2. 31 U.S.C. § 1341(a).
3. See Chapter II.C.4.
4. See Chapter IV.D.
5. 54 Comp. Gen. 824, 826-7 (1975).
6. 60 Comp. Gen. 584, 585 (1981).
7. B-201072, May 3, 1982.
8. Telephone interview with Mrs. Rollee Efros, Assistant General Counsel, U.S. General Accounting Office (Feb. 1984).
9. 62 Comp. Gen. 361, 367 (1983).
10. Id. at 366.
11. Id.
12. Id. at 367.
13. 54 Comp. Gen. 824, 826-7 (1975).
14. 62 Comp. Gen. 361, 365 (1983).
15. 42 Comp. Gen. 708, 712-3 (1963).
16. Federal Appropriations Law, supra ch. I note 4, at 6-41.
17. 2 GAO 13.3, Contingent Liabilities, 2-39.
18. See e.g., 37 Comp. Gen. 691 (1958).
19. 54 Comp. Gen. 824, 827 (1975).
20. Letter from Robert D. Wallick, Chairman, Public Contracts Law Section, American Bar Association, to the Comptroller General of the United States (March 16, 1983) [hereinafter cited as Wallick Letter].

21. See Chapter V.D.2.
22. 34 Comp. Gen. 418, 420-1 (1955).
23. 54 Comp. Gen. 824, 826-7 (1975).
24. DOD 7220.9-M Chapter 25 C., 25-1 (1983).
25. Id. at 25-1.
26. DOD 7220.9-H, 21003 Violations of Section 3679 of the Revised Statutes, B.6. (1978).
27. Exec. Ord. No. 12148, 3 Fed. Reg. 13755 (1979).
28. OMB Cir. A-34, supra ch. 2 note 25, at Part II 21.1.
29. Exec. Ord. No. 10789, 23 Fed. Reg. 8897 (1958); Exec. Ord. No. 11051, 27 Fed. Reg. 9683 (1962); Exec. Ord. No. 11382, 32 Fed. Reg. 16247 (1967); Exec. Ord. No. 11610, 36 Fed. Reg. 13755 (1971); Exec. Ord. No. 12148, 44 Fed. Reg. 43239 (1979).
30. Exec. Ord. No. 12148, supra note 25.
31. S. Rep. No. 96-207, 96th Cong., 2d Sess. 47, reprinted in 1979 U.S. Code Cong. & Ad. News 829, 832.
32. B-201072, May 3, 1982.
33. 42 U.S.C. § 2458b(b).
34. H.R. Rep. No. 2232, 85th Cong., 2d Sess. 6 (1958).
35. See NASA Procurement Notice 83-3 (Jan. 20, 1983); FAA Air Traffic Control Computer Replacement Program, Fed. Reg. Dec. 24, 1981, 62596.
36. Interview with Mr. Jonathan Blucher, HQ AFSC/JAN, Andrews AFB, D.C. (May 1983).
37. H.R. 4199, 98th Cong. 1st Sess. (1983); S. 1839, 98th Cong. 1st Sess. (1983).
38. H.R. 4199, supra note 37, at § 5(a); S. 1839, supra, note 37, at

§ 5(a).

39. H.R. 4199, supra note 37, at § 5(g)(1); S. 1839, supra note 37, at § 5(g)(1).

40. H.R. 4199, supra note 37, at § 5(g)(1).

41. Chapter III.C.

42. Chapter III.B.

43. Chapter IV.C.

44. 10 U.S.C. §§ 2306 (g)(1), (h)(1).

45. H.R. Rep. No. 97-71, Part II, 97th Cong. 1st Sess. 20, reprinted in 1981 U.S. Code Cong. & Ad. News 1801, 1817-8.

46. Black's Law Dictionary 392 (Rev. 4th ed. 1968).

47. 10 U.S.C. § 2306(h)(1)(A).

48. 10 U.S.C. § 2306(h).

49. 10 U.S.C. § 2306(h)(5).

50. Chapter V.D.

51. OMB Cir. A-34, supra ch. 2 note 25, at Part II 21.1.

52. id.

53. 2 U.S.C. § 652(f).

54. Id.

55. B-197583, Jan. 19, 1981. See also discussion at 62 Comp. Gen. 361, 364 (1983).

56. 59 Comp. Gen. 705, 705-6 (1980).

57. Id. at 707.

58. B-197583, Jan. 19, 1981.

59. See Chapter II.D.3.

60. 62 Comp. Gen. 361, 367 (1983).

61. Id. at 364.

62. See, e.g., 26 Am. Jur. 2d Electricity, Gas, and Steam § 39 (1966).

63. The only other possible theory is strict tort liability. That theory has not proven successful in these situations in suits brought against electric companies. See Annot., 82 A.L.R.3d 218 (1978). The author's own telephone interview (Feb. 1984) with the claims division of the legal office of PEPCO, the utility in question in B-197583, confirmed the analysis set forth in the text. It is not possible to reconcile the representations made during that interview with GSA's assertion in 59 Comp. Gen. 705, 706-7, that limiting language "would be unacceptable to the utilities...because there is no real assurance that they would be protected in the event of a large award for personal injury."

64. 59 Comp. Gen. 705, 707 (1980).

65. B-197583, Jan. 19, 1981: "However, unlike [59 Comp. Gen. 705], here there is another source for performing the test, that is, the Government employees who in fact have performed the tests in the past."

66. Federal Appropriations Law, supra ch. I note 4, at 6-43, 6-44.

67. Report of the OFPP Interagency Task Force on Indemnification, Part I, Indemnification of Government Contractors against Third Party Liability Claims, 3 (Jan. 28, 1982).

68. Id. at 4.

CHAPTER V

1. Report of Commission on Government Procurement, Vol. 4 Ch. 3, 100 (Dec. 1972).
2. 62 Comp. Gen. 361 (1983); B-206626, July 27, 1982.
3. H.R. 4199, 98th Cong. 1st Sess. (1983); S. 1839, 98th Cong. 1st Sess. (1983).
4. Report of the OFPP Interagency Task Force on Indemnification, Part I, Indemnification of Government Contractors against Third Party Liability Claims (Jan. 28, 1982).
5. FAR 52.228-7(d).
6. FAR 52.228-7(c)(2).
7. See FAR Part 31.
8. "Incrementally funded contracts" are described at Chapter V.D.2.a.
9. FAR 52.232-20, FAR 52.232-21.
10. FAR 52.232-22.
11. See e.g., FAR 52.232-20(d)(2).
12. B-201072, May 3, 1982.
13. Navy Contract Law, 221 (1st ed. 1949).
14. DOJ Memo, supra ch. 3 note 32.
15. Id. at 8-9.
16. Id. at 9-10.
17. Id.
18. See discussion at Chapter II.D.4.
19. FAR 52.228-7(d).
20. See Chapter IV.A.4.
21. Note 3, supra.

22. DAR 3-404.3 (July 1976).
23. FAR 16.203.
24. DAR 3-404.4(a)(2) (DAC 76-16 Aug 1978).
25. Id.
26. FAR 16.403(b).
27. B-116795, June 18, 1954.
28. See generally Federal Appropriations Law, supra ch. I note 4, at 6-2 -- 6-7.
29. See, e.g., DOD 7220.9-M Chapter 24 ¶ B.3.a.(1). Misunderstanding of the distinction between "obligations" and "commitments" has been the source of added confusion in the entire area of administrative reservation of funds requirements. For example, in 42 Comp. Gen. 708 the FAA argued that it should not have to establish a reservation of funds because its contingent liability didn't meet the requirements for recording an obligation, 42 Comp. Gen. 708, 710. GAO agreed, id. at 712. However, the argument was not to the point. Simply because a contingent liability does not meet the criteria for recording an obligation does not answer the question of whether or not a "commitment" (administrative reservation of funds) needs to be established. This is true regardless of whether one is applying business and accounting rules regarding the probability of the contingency happening, or legal rules dependent upon the factual possibility of occurrence.

In 60 Comp. Gen. 584 exactly the reverse of 42 Comp. Gen 708 happened. There, GAO said that the agency should have "obligated money to cover possible liability" under a risk of loss provision, 60 Comp.

Gen. 584, 585. However, a contingent obligation does not meet the criteria for recording an obligation. In some instances GAO has hedged on this problem and said that funds should be either "obligated or administratively reserved," e.g., 62 Comp. Gen. 361, 365.

In spite of all this confusion, the author is of the opinion that the greatest confusion was caused by 42 Comp. Gen. 708. It implied that unless a contingent liability met the requirements of an obligation (as defined in 31 U.S.C. § 1501(a)), no administrative reserve would be required. If such were the rule, an administrative reserve would never be required because the definition of "obligation" excludes contingent liabilities. This confusion should have ended with the decision in 54 Comp. Gen. 824, which required an administrative reservation of funds for all contingent liabilities not subject to a limitation of liability clause.

30. DOD 7220.9-M Chapter 25 D.2., 25-2.

31. Chapter IV.B.

32. DOD 7220.9-M Chapter 25 C.1., 25-1.

33. See Chapter IV. A.

34. 34 Comp. Gen. 418, 420-1 (1955).

35. 42 Comp. Gen. 708 (1963).

36. 54 Comp. Gen. 824 (1975).

37. Chapter IV.B.2.

38. Chapter IV.A.4.

39. 31 U.S.C. § 1341(a)(1).

40. See e.g., FAR 52.243-7 Notification of Changes.

41. FAR 52.236-2.

42. Nash & Cibinic, supra ch. I note 3, at 1206-7.
43. Id. at Ch. 18.
44. See Cibinic & Nash, Administration of Government Contracts, 264-5 (1981).
45. See, e.g., FAR 52.243-1(a).
46. It has been argued that this was attempted by the Navy in 1970 with its "Anti-Claims Clauses." F.T. vom Bauer wrote in 29 Fed. B.J. 305, 357 (1970):

As appears from their title, these clauses have as their objective the elimination or at least the cutting down of claims, no matter how meritorious they might otherwise be. The specific approach of the "Anti-Claims Clauses," is to place new technical burdens on the contractor, seeking to restrict or eliminate his rights to compensation for the increased costs of constructive change orders issued by the Government. For instance, under these clauses the contractor is required to give notice, within 10 days of the receipt of a constructive change order issued by the Government, to the effect that he has received it and considers it to be a constructive change order. If the contractor fails to give such a notice, he is held by the clauses to be barred from collecting for the additional work performed at the direction of the Government. Another provision seeks to compel the contractor to waive claims for delay and disruption even when the Government refuses to pay him for these costs.

Thus, the "Anti-Claims Clauses" mark a...heavy shift of risk to contractors....[B]y virtue of these [clauses], we see the Government seeking to eliminate or whittle away, by complicated technical manoevers, the payment of compensation for the contractor's increased costs incurred as a result of directions of the Government occurring after contract execution.

These clauses are no longer in use. See also R. Nash, Government Contract Changes 253-4 (1975).

47. FAR 52.243-4(d).
48. See generally Administration of Government Contracts, supra note

44, at 200-3.

49. Chapter II.D.4.

50. 172 Ct.Cl. 60, 348 F.2d 475 (1965).

51. 12 U.S.C. §§ 1748-1748(a)-(g); 42 U.S.C. §§ 1594-1594f.

52. 348 F.2d at 483.

53. 183 Ct.Cl. 694, 392 F.2d 984 (1968).

54. 392 F.2d at 985.

55. Id. at 986.

56. 348 F.2d at 483.

57. 392 F.2d at 987.

58. Id. at 986.

59. 256 U.S. 575 (1921).

60. Id. at 579-80.

61. Id. at 580-81.

62. 31 U.S.C. § 724a. In the case of contract awards, 41 U.S.C. § 612(c) makes this fund subject to reimbursement by "the agency whose appropriations were used for the contract."

63. E.g., Dougherty v. United States, 18 Ct.Cl. 496 (1883); Ferris v. United States, 27 Ct.Cl. 542 (1892).

64. Wallick letter, supra ch. IV note 17, at 5.

65. Letter from Karl G. Harr, Jr.; President, Aerospace Industries Ass'n of America, Inc. to James T. Brannan, Director, Defense Acquisition Regulatory Council (November 16, 1982).

66. Fenster & Voltz, supra ch. II note 16, at 212-3.

67. Id. at 197.

68. Id. at 215-217.

69. FAR 52.236-2.
70. FAR 36.502.
71. Cibinic & Nash, supra note 44, at 205.
72. 37 Comp. Gen. 691, 694 (1958).
73. See Chapter V.B.1.
74. See Chapter V.B.2.
75. FAR 52.236-2(a).
76. 681 F.2d 756 (Ct.Cl. 1982).
77. Id. at 771.
78. The strict holding of Torncello is only that the Government "may not use the standard termination for convenience clause to dishonor, with impunity, its contractual obligations," Id. at 772, in a situation involving a requirements contract.
79. FAR Subpart 49.5.
80. G.L. Christian & Associates v. United States, 160 Ct.Cl. 1, 312 F.2d 418, rehearing, 160 Ct.Cl. 58, 320 F.2d 345, cert. denied, 375 U.S. 954 (1963), 170 Ct.Cl. 902, cert. denied, 382 U.S. 821 (1965).
81. Colonial Metals Co. v. United States, 204 Ct.Cl. 320, 495 F.2d 1355 (1974).
82. 681 F.2d 756, supra note 76.
83. Id. at 772.
84. See, e.g., FAR 52.243-1(f).
85. See Cibinic & Nash, supra note 44, at 504.
86. DOD 7200.4, Full Funding of DoD Procurement Programs, Encl. 2 2-1 (Sept. 6 1983).
87. Id. at Encl. 2, 2-2.

88. Dep. Sec. Def. Memorandum for Secretaries of the Military Departments, Directors, Defense Agencies, Encl. 1 (May 1, 1981) [hereinafter cited as Carlucci Memo].
89. 10 U.S.C. § 2306(h)(2)(B).
90. DOD 7200.4, supra note 86, at Encl. 2 2-2.
91. Id.
92. 48 Comp. Gen. 497, 502 (1969).
93. See text at note 29, supra.
94. 48 Comp. Gen. 497 (1969).
95. H.R. Rep. No. 349, 90th Cong., 1st Sess. 40-1 (1967).
96. See, generally, Federal Appropriations Law, supra ch. I note 4, at Ch. 3 C.(9).
97. B-159141 2 (1967).
98. Id. at 4.
99. Id. at 4-5.
100. DOD 7220.9-M Chapter 25 C.6.
101. Fenster & Voltz, supra ch. II note 16, at 204-5.
102. See Chapter II.D.4.
103. 51 Comp. Gen. 598, 599 (1972).
104. Id. at 604.
105. Id. at 603.
106. Id. at 605.
107. Id. at 603.
108. Id. at 605-6.
109. See text at note 101, supra.
110. B-159141, supra note 97 at 5.

111. Id. at 3.
112. 51 Comp. Gen. 598, 602 (1972).
113. H.R. Rep. No. 349, supra note 95, at 41.
114. Fenster & Voltz, supra ch. II note 16, at 219.
115. Pub.L. 97-86, Title IX, §§ 907(b), 909(b), 95 Stat. 1111, 1113 (Dec. 1, 1981).
116. Chapter IV.C.1.c.
117. AF Office of the General Counsel Memorandum for SAF/AL, Subject: H.R. 745 Atch 1 4-5 (Mar. 26, 1981).
118. 10 U.S.C. § 2306(h)(5).
119. Federal Appropriations Law, supra ch. I note 4, at 4-9.
120. AF Memo, supra note 117, at Atch 1 6.
121. P.L. 97-377, H.J.Res. 631, 96 Stat. 1830 (Dec. 21, 1982).
122. Id. at 96 Stat. 1861.
123. DOD FAR Supplement 49.7003
124. Carlucci Memo, supra note 88, at Encl. 1.
125. FAR 52.232-22(b) Limitation of Funds. The Limitation of Cost clauses, FAR 52.232-20, -21 operate under the same concept.
126. See notes 9 & 10, supra.
127. Chapter V.A.
128. DOD 7200.4, supra note 86, at D.
129. DOD FAR Supplement 52.249-7000(a).
130. See text at note 90, supra.
131. See text at note 100, supra.
132. Memorandum for Mr. Mitchell, SAF/FMP, Atch B 2-4 (July 8, 1981).
133. 42 Comp. Gen. 708, 712 (1963).

134. See text at note 95, supra.
135. Memorandum for Mr. Mitchell, supra note 132, at Atch B 1.
136. S. Rep. No. 93-385, 93d Cong. 1st Sess., 118-9 (1983).
137. 10 U.S.C. § 2306(h).
138. 10 U.S.C. § 2306(g).
139. S. Rep. No. 93-385, supra note 136, at 119.

CHAPTER VI

1. Hopkins & Nutt, supra ch. I note 12, at 134.
2. See generally, Fenster & Voltz, supra, ch. II note 16, at 219.
3. E.g. AF Pamphlet 170-19, supra ch. II note 1.
4. See discussion at Chapter II.B.
5. Wallick Letter, supra ch. IV note 20.
6. See discussion at Chapter II.A.3.
7. E.g. 42 Comp. Gen. 708 (1963).