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B-197274, Sep 23, 1983

Number: B-197274

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B-197274, SEP 23, 1983

DIGEST: WHERE A LETTER CONTRACT AND THE SUBSEQUENT SUPERSEDING AGREEMENT ARE ENTERED INTO DURING THE SAME FISCAL YEAR, THE COST OF BOTH CONTRACTS IS OBLIGATED AGAINST THE SAME FISCAL YEAR APPROPRIATION. HOWEVER, WHEN THE LETTER CONTRACT IS ENTERED INTO DURING ONE YEAR AND THE SUPERSEDING AGREEMENT IS NOT DEFINITIZED UNTIL THE NEXT FISCAL YEAR, THEN IT IS APPROPRIATE TO OBLIGATE ONLY THE MAXIMUM LIABILITY WHICH MAY BE INCURRED UNDER THE LETTER CONTRACT AGAINST APPROPRIATIONS CURRENT WHEN IT IS ENTERED INTO. THE SUPERSEDING CONTRACT IS OBLIGATED AGAINST APPROPRIATIONS CURRENT WHEN IT IS DEFINITIZED AND ENTERED INTO.

OBLIGATING LETTER CONTRACTS:

THIS DECISION IS IN RESPONSE TO AN INQUIRY FROM KAMAL J. RAHAL, DIRECTOR OF THE PROCUREMENT AND CONTRACTS STAFF, OFFICE OF PERSONNEL AND ADMINISTRATION, JUSTICE MANAGEMENT DIVISION, DEPARTMENT OF JUSTICE, SEEKING OUR GUIDANCE REGARDING THE CORRECT MANNER OF RECORDING THE TOTAL OBLIGATION FOR LETTER CONTRACTS COVERING BONA FIDE, NONSEVERABLE REQUIREMENTS OF A GIVEN FISCAL YEAR WHEN AN ANNUAL APPROPRIATION IS INVOLVED AND THE LETTER CONTRACTS MAY NOT BE DEFINITIZED BEFORE THE END OF THE FISCAL YEAR.

THE DIRECTOR'S INQUIRY IS PROMPTED BY DIFFICULTY INCURRED IN APPLYING PRINCIPLES STATED IN TWO RECENT DECISIONS OF THIS OFFICE. OUR DECISION IN THE MATTER OF HUD'S OBLIGATING NO YEAR CONTRACT AUTHORITY, B-197274, FEBRUARY 16, 1982, STATED THAT LETTER CONTRACTS: "*** MAY BE RECORDED AS OBLIGATIONS ONLY TO THE EXTENT OF THE AMOUNT NECESSARY TO COVER EXPENSES TO BE INCURRED BY THE CONTRACTOR PRIOR TO THE EXECUTION OF THE DEFINITIVE CONTRACT, 34 COMP.GEN. 418, 421 (1955); B-127518, MAY 10, 1956."

ADDITIONALLY, OUR DECISION IN THE MATTER OF OBLIGATIONS AND CHARGES UNDER SMALL BUSINESS SERVICE CONTRACTS, 60 COMP.GEN. 219 (1981), INDICATED THAT UNDER THE "BONA FIDE NEED" RULE ESTABLISHED BY THIS OFFICE WHEN CONSTRUING 31 U.S.C. SEC. 1501 (FORMERLY 31 U.S.C. SEC. 712A), ANNUAL APPROPRIATIONS MAY ONLY BE APPLIED TO THE PAYMENT OF EXPENSES PROPERLY INCURRED DURING THAT YEAR, THAT IS, A "BONA FIDE NEED" WHICH EXISTS AT THE TIME THE CONTRACT IS EXECUTED.

FURTHERMORE, WE POINTED OUT THAT SINCE 31 U.S.C. SEC. 1501 MAKES APPROPRIATIONS UNAVAILABLE FOR GOODS OR SERVICES WHICH DO NOT REPRESENT A BONA FIDE NEED OF THE FISCAL YEAR SOUGHT TO BE CHARGED, IF A VALID CONTRACT OBLIGATION FOR SERVICES AROSE IN THE PRIOR FISCAL YEAR, FUNDS OF THE SUBSEQUENT FISCAL YEAR COULD NOT BE USED TO PAY FOR THEM WITHOUT VIOLATING THE PROHIBITION OF 31 U.S.C. SEC. 1341(A) (FORMERLY 31 U.S.C. SEC. 665(A)).

BASED UPON THESE TWO DECISIONS THE DIRECTOR QUESTIONS WHETHER LETTER CONTRACTS ENTERED INTO DURING ONE FISCAL YEAR MAY BE SUPERSEDED BY A DEFINITIZED CONTRACT ENTERED INTO DURING A SUBSEQUENT FISCAL YEAR. STATES:

"IN ACCORDANCE WITH 41 CFR 1-3.408(C)(4), SUCH LETTER CONTRACTS NORMALLY STATE A MAXIMUM GOVERNMENT COST LIABILITY GENERALLY NOT EXCEEDING 50 PER CENT OF THE TOTAL ESTIMATED COST OF THE PROCUREMENT. WHEN THESE LETTER CONTRACTS ARE DEFINITIZED, ADDITIONAL FUNDING HAS TO BE AVAILABLE TO COVER NEGOTIATED COSTS IN EXCESS OF INITIAL GOVERNMENT COST LIABILITY OF THAT DOLLAR AMOUNT.

"IN VIEW OF THE 'BONA FIDE NEED' RULE, WE MUST CONCLUDE THAT TOTAL FUNDING FOR THESE LETTER CONTRACTS AND THE SUPERSEDING DEFINITIZED CONTRACTS HAS TO COME FROM THE FUNDS OF THE FISCAL YEAR IN WHICH THE BONA FIDE NEED FOR A NONSEVERABLE REQUIREMENT AROSE AND THE LETTER CONTRACT WAS EXECUTED. BECAUSE AN ANNUAL APPROPRIATION IS INVOLVED, THE OBLIGATION OF THESE FUNDS WOULD HAVE TO TAKE PLACE BEFORE THE FISCAL YEAR ENDED. OTHERWISE, THE ADDITIONAL FUNDS REQUIRED FOR DEFINITIZATION WOULD NORMALLY NO LONGER BE AVAILABLE.

"GIVEN THE 'BONA FIDE NEED' RULE, THE APPLICATION OF YOUR DECISION B-197274 TO LETTER CONTRACTS UNDER THE CIRCUMSTANCES SET FORTH ABOVE PLACES CONSIDERABLE PRESSURE ON THE GOVERNMENT TO SETTLE WITH CONTRACTORS AND DEFINITIZE THESE LETTER CONTRACTS NOT LATER THAN THE END OF THE FISCAL YEAR IN WHICH THEY WERE EXECUTED. IF THE GOVERNMENT DID NOT DO SO, NEITHER FUNDS FOR THAT FISCAL YEAR NOR THE FOLLOWING FISCAL YEAR APPEAR TO BE AVAILABLE FOR DEFINITIZATION. FURTHERMORE, THE MAXIMUM GOVERNMENT COST LIABILITY SET FORTH IN EACH OF THESE LETTER CONTRACTS WOULD BECOME THE PRICE CEILING FOR A CONTRACT DEFINITIZED IN A SUBSEQUENT FISCAL YEAR. BECAUSE THIS DOLLAR AMOUNT IS GENERALLY 50 PER CENT OR LESS OF THE TOTAL ESTIMATED COST, IT IS HIGHLY UNLIKELY THAT SETTLEMENT AND DEFINITIZATION WOULD OCCUR. MOST LIKELY, THESE LETTER CONTRACTS WOULD HAVE TO BE TERMINATED, THE CONTRACTOR WOULD RECEIVE PAYMENT FOR THE WORK HE HAD PARTIALLY PERFORMED AND THE GOVERNMENT WOULD BE WITHOUT THE COMPLETED PRODUCT OR SERVICE FOR WHICH IT HAD CONTRACTED.

"LATE IN FISCAL YEAR 1982, WE FOUND IT NECESSARY TO LET TWO LETTER CONTRACTS COVERING BONA FIDE, NONSEVERABLE REQUIREMENTS OF THAT FISCAL YEAR, FUNDED BY AN ANNUAL APPROPRIATION FOR THAT FISCAL YEAR. IT WAS APPARENT THAT DEFINITIZATION OF THESE LETTER CONTRACTS COULD NOT TAKE PLACE BEFORE THE FISCAL YEAR ENDED. ACCORDINGLY, THE ACCOUNTING AND APPROPRIATION DATA ON THE FACE OF THESE LETTER CONTRACTS PROVIDED FUNDING IN AN AMOUNT ESTIMATED AS SUFFICIENT TO COVER TOTAL CONTRACT PERFORMANCE UNDER THE LETTER CONTRACTS AND THE SUPERSEDING DEFINITIZED CONTRACTS. IN EACH INSTANCE, THE MAXIMUM MONETARY LIABILITY OF THE GOVERNMENT WAS SET FORTH AS 50 PER CENT OF THAT AMOUNT. THIS PROCEDURE APPEARS TO CONFLICT WITH YOUR DECISION IN B-197274 ***.

HOWEVER, IT IS OUR VIEW THAT THE FOREGOING PROCEDURE OF OBLIGATING FUNDS ON THE LETTER CONTRACT (WHILE LIMITING THE GOVERNMENT'S LIABILITY TO 50 PER CENT OR LESS OF THAT AMOUNT) ESTABLISHES THE MAXIMUM MONETARY LIABILITY OF THE GOVERNMENT UNDER THE LETTER CONTRACT

AND COMPLIES WITH THE 'BONA FIDE NEED' RULE BECAUSE FUNDS OF THE APPROPRIATE FISCAL YEAR HAVE BEEN SET ASIDE FOR DEFINITIZATION PURPOSES.

"IF THIS PROCEDURE IS NOT ACCEPTABLE, WE REQUEST YOUR ADVICE AS TO AN ACCEPTABLE PROCEDURE TO MAKE ADDITIONAL FUNDS AVAILABLE FROM AN ANNUAL APPROPRIATION AFTER THE FISCAL YEAR HAS ENDED. ***"

IT APPEARS THAT THE QUESTION PRESENTED ARISES FROM A MISCONCEPTION OF THE BONA FIDE NEED RULE. UNDER THAT RULE, OBLIGATIONS MAY ONLY BE INCURRED TO SATISFY BONA FIDE NEEDS OF THE PERIOD OF APPROPRIATION AVAILABILITY. THAT IS NOT TO SAY, HOWEVER, THAT THE NEEDS OF A PARTICULAR PERIOD MUST BE FULLY SATISFIED DURING THAT PERIOD. AN UNFULFILLED NEED OF ONE PERIOD MAY WELL BE CARRIED FORWARD TO THE NEXT AS A CONTINUING NEED WITH THE NEXT PERIOD'S APPROPRIATION BEING AVAILABLE FOR FUNDING.

WE NOTE THAT LETTER CONTRACTS ARE USED ONLY WHEN NO OTHER CONTRACTUAL ARRANGEMENT IS POSSIBLE TO COVER PAYMENTS FOR WORK WHICH MUST BE COMMENCED IMMEDIATELY, BUT PRIOR TO ALL THE DETAILS (SOMETIMES INCLUDING COST) HAVING BEEN AGREED UPON BY THE PARTIES. SEE 41 C.F.R. SEC. 1-3.408. THUS WHEN A LETTER CONTRACT IS ENTERED INTO, THE PARTIES CONTEMPLATE REACHING AGREEMENT AS TO CERTAIN MATTERS WHICH WILL LATER BE RECORDED IN THE DEFINITIZED AGREEMENT AND THIS CONTRACT WILL THEN SUPERSEDE THE LETTER CONTRACT. BECAUSE OF THE INDEFINITE NATURE OF THE TRANSACTION TO WHICH THE LETTER CONTRACT APPLIES (INCLUDING PRICE) AGENCIES ARE REQUIRED TO INCLUDE A STATEMENT OF THE GOVERNMENT'S MAXIMUM LIABILITY TO ASSURE THAT THE CONTRACTOR DOES NOT INCUR COSTS IN EXCESS OF AMOUNTS AVAILABLE IN APPROPRIATIONS OR APPORTIONMENTS FOR THAT CONTRACT. OTHERWISE, VIOLATIONS OF 31 U.S.C. SECS. 1341 OR 1517 (FORMERLY 31 U.S.C. SEC. 665(A) OR (H) RESPECTIVELY) MIGHT OCCUR.

FN1 THUS THIS CLAUSE LIMITS THE MAXIMUM RECORDABLE OBLIGATION UNDER THE CONTRACT.

CONSEQUENTLY, WHERE A LETTER CONTRACT AND THE SUBSEQUENT SUPERSEDING AGREEMENT ARE ENTERED INTO DURING THE SAME FISCAL YEAR, THE COST OF BOTH CONTRACTS IS OBLIGATED AGAINST THE SAME FISCAL YEAR APPROPRIATION. HOWEVER, WHEN THE LETTER CONTRACT IS ENTERED INTO DURING ONE YEAR AND THE DEFINITIZED AGREEMENT DURING THE NEXT, THEN IT IS APPROPRIATE TO OBLIGATE ONLY THE AMOUNT OF THE MAXIMUM LIABILITY WHICH MAY BE INCURRED UNDER THE LETTER CONTRACT SINCE THE UNDERLYING CONTRACT DOCUMENT SUPPORTS OBLIGATING NO MORE. ONCE THE AGREEMENT IS DEFINITIZED (WHICH IS BY NO MEANS A CERTAINTY) THE LETTER CONTRACT IS SUPERSEDED AND THE LEGAL LIABILITY OF THE PARTIES IS MERGED INTO THE NEW CONTRACT. THE DEFINITIZED CONTRACT THEN SUPPORTS OBLIGATING AGAINST THE APPROPRIATION CURRENT AT THE TIME IT IS ENTERED INTO SINCE IT IS, IN FACT, A BONA FIDE NEED OF THAT YEAR. THE AMOUNT OF THE DEFINITIZED CONTRACT WOULD ORDINARILY BE THE TOTAL CONTRACT COST LESS EITHER THE ACTUAL COSTS INCURRED UNDER THE LETTER CONTRACT (WHEN KNOWN) OR THE AMOUNT OF THE MAXIMUM LEGAL LIABILITY PERMITTED BY THE LETTER CONTRACT (WHEN THE ACTUAL COSTS CANNOT BE DETERMINED). FN2

WE NOTE THAT WE HAVE HELD THAT COST INCREASES IN COST REIMBURSEMENT CONTRACTS WHICH EXCEED CONTRACTUALLY STIPULATED CEILINGS AND WHICH ARE NOT BASED ON AN ANTECEDENT LIABILITY ENFORCEABLE BY THE CONTRACTOR MAY PROPERLY BE CHARGED TO FUNDS AVAILABLE WHEN THE DISCRETIONARY INCREASE IS GRANTED BY THE CONTRACTING OFFICER. FN3 SINCE THE GOVERNMENT IS NOT LEGALLY LIABLE BEYOND THE AMOUNT SET FORTH IN THE LETTER CONTRACT, AND ANY ADDITIONAL LIABILITY IS NOT INCURRED UNTIL THE GOVERNMENT AND THE CONTRACTOR DEFINITIZE THEIR AGREEMENT, WE SEE NO REASON FOR NOT FOLLOWING A RULE SIMILAR TO THAT ARTICULATED WITH REGARD TO OBLIGATING FUNDS UNDER COST CONTRACTS.

FN1 31 U.S.C. SEC. 1341 PROVIDES:

"(A)(1) AN OFFICER OR EMPLOYEE OF THE UNITED STATES GOVERNMENT OR OF THE DISTRICT OF COLUMBIA GOVERNMENT MAY NOT -

"(A) MAKE OR AUTHORIZE AN EXPENDITURE OR OBLIGATION EXCEEDING AN AMOUNT AVAILABLE IN AN APPROPRIATION OR FUND FOR THE EXPENDITURE OR OBLIGATION; OR

"(B) INVOLVE EITHER GOVERNMENT IN A CONTRACT OR OBLIGATION FOR THE PAYMENT OF MONEY BEFORE AN APPROPRIATION IS MADE UNLESS AUTHORIZED BY LAW. ***"

31 U.S.C. SEC. 1517 PROVIDES:

"(A) AN OFFICER OR EMPLOYEE OF THE UNITED STATES GOVERNMENT OR OF THE DISTRICT OF COLUMBIA GOVERNMENT MAY NOT MAKE OR AUTHORIZE AN EXPENDITURE OR OBLIGATION EXCEEDING -

"(1) AN APPORTIONMENT; OR

"(2) THE AMOUNT PERMITTED BY REGULATIONS PRESCRIBED UNDER SECTION 1514(A) OF THIS TITLE. ***"

FN2 SEE 31 U.S.C. SEC. 1501 WHICH PROVIDES:

"(A) 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 END 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; ***"

FN3 SEE OUR DECISION IN THE MATTER OF THE ENVIRONMENTAL PROTECTION AGENCY - REQUEST FOR CLARIFICATION OF B-195732, JUNE 11, 1980, 59 COMP.GEN. 518, 61 COMP.GEN. 609 (1982).