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Comptroller General
of the United States

United States General Accounting Office
Washington, DC 20548

Decision

Matter of: Assignment of Losses Incurred by the Library of Congress FEDLINK Revolving Fund

File: B-301714

Date: January 30, 2004

DIGEST

The Library of Congress has incurred losses as a result of advance payments made for the acquisition of subscriptions by the Federal Library and Information Network (FEDLINK) revolving fund to a contractor who subsequently defaulted and declared bankruptcy. The Library should use the administrative fees that it has collected from all of FEDLINK's customers to cover this loss, rather than assign the loss to the specific agencies whose orders were placed with the contractor.

DECISION

The Library of Congress has requested our decision concerning the assignment of losses incurred by the Federal Library and Information Network (FEDLINK) revolving fund as a result of advance payments made to a defaulting contractor. Letter from Elizabeth Pugh, General Counsel, The Library of Congress, to Anthony Gamboa, General Counsel, General Accounting Office, August 15, 2003 (Pugh Letter). Specifically, the Library asks whether the revolving fund or the specific agencies on whose behalf the Library had placed orders with the defaulting contractor should bear the cost of the losses associated with the default. If the revolving fund, as opposed to the specific customer agencies, bears the losses, the Library would use the fund's reserve accumulated through the assessment of administrative fees to all of FEDLINK's customers. As explained below, we conclude that the FEDLINK revolving fund should cover the losses.

BACKGROUND

The Library of Congress operates the FEDLINK intragovernmental revolving fund pursuant to 2 U.S.C. § 182c. FEDLINK is a cooperative procurement, accounting, and training program designed to provide access to online databases, periodical

subscriptions, books, and other library and information support services from commercial suppliers with which the Library has negotiated contracts. 2 U.S.C. § 182c(f)(1). Federal agencies place orders for these products and services with FEDLINK and are able to take advantage of volume discounts.

At issue here are orders for periodical subscriptions that agencies sought to acquire through FEDLINK. Once a federal agency customer executes an interagency agreement with FEDLINK, the Library issues a purchase order to a subscription vendor authorizing the vendor to place the agency's subscription orders with the appropriate publishers. Section 182c(c)(2) authorizes the Library to collect advance payments from its customer agencies, and the Library forwards the advance payments to the subscription vendor, pursuant to 31 U.S.C. § 3324(d)(2).[1]

In fiscal year 2003, the Library became aware that RoweCom, a subscription vendor to which it had made advance payments, had neither placed subscription orders nor made the required payments to publishers. Pugh Letter. Since RoweCom was not fulfilling the terms of its FEDLINK contracts, the Library terminated the contracts for default under *Federal Acquisition Regulation* procedures.[2] Id. Subsequently, RoweCom filed for Chapter 11 bankruptcy protection.

FEDLINK filed a claim of approximately $3.5 million in the bankruptcy proceeding. Of that amount, the Library expects approximately $3 million will be satisfied by the delivery of subscriptions by RoweCom or by publishers to whom a corresponding portion of the claim will be subrogated. Id. Although RoweCom's creditors will ultimately receive some payment from the bankruptcy estate, FEDLINK is unlikely to be reimbursed the full amount of the remaining $500,000 of its claim. Id.

Since the interagency agreements between FEDLINK and its customer agencies do not address issues associated with contractor defaults, the Library has asked us whether the subscribing federal agencies or the FEDLINK revolving fund should bear the loss associated with RoweCom's bankruptcy. The Library has found no precedent on this issue. Pugh Letter. Advance payments to contractors are generally prohibited by 31 U.S.C. § 3324. However, there is an exception to this general prohibition for publications. 31 U.S.C. § 3324(d)(2).

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[1] Title 31 of the U.S. Code, section 3324(d)(2), permits agencies to make advance payments for "charges for a publication printed or recorded in any way for the auditory or visual use of the agency."

[2] The Library relied upon 48 C.F.R. § 49.401 to terminate RoweCom's contract.

ANALYSIS

The FEDLINK statute does not directly address the issue of whether losses incurred as a result of a contractor's bankruptcy should be charged to the FEDLINK revolving fund or to the federal library customers whose orders FEDLINK placed with the bankrupt contractor. The statute simply creates FEDLINK as a revolving fund and permits the Library to charge "fees" to federal libraries for "the procurement of commercial information services, publications in any format, and library support services; related accounting services; [and] related education, information, and support services." 2 U.S.C. § 182c(c)(1), (f)(1).

Since the statute does not directly address the issue of whether the FEDLINK revolving fund or its customer agencies should bear the losses associated with RoweCom's bankruptcy, we turn to the legislative history behind the creation of the FEDLINK revolving fund. This legislative history indicates that FEDLINK was designed to function like a self-sustaining business. For example, in discussing the legislation that created the FEDLINK fund (H.R. 5410) shortly before its passage by the House of Representatives, sponsor Representative Bill Thomas stated that the legislation would allow FEDLINK to operate as a private enterprise, "[in] that monies garnered from various activities could be retained by the Library to be reinvested in those areas." 146 Cong. Rec. H10016 (daily ed. Oct. 17, 2000).[3] In addition, when introducing a substantially similar bill (H.R. 4180), Representative Steny Hoyer, then Ranking Minority Member of the House Administration Committee, stated that the purpose of the legislation was to place the Library's service program operations "on a more business-like foundation." 146 Cong. Rec. H1822 (daily ed. Apr. 5, 2000). Representative Hoyer repeatedly referred to the need to turn FEDLINK and other similar Library programs into a more "business-type" structure. Id.

The history of revolving funds in the federal government demonstrates that they are intended to behave like a private sector business.[4] Intragovernmental revolving

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[3] H.R. 5410 was agreed to by voice vote in the House of Representatives on October 17, 2000. 146 Cong. Rec. H10017 (daily ed. Oct. 17, 2000). It passed the Senate without amendment by unanimous consent on October 31, 2000. 146 Cong. Rec. S11436 (daily ed. Oct. 31, 2000). Neither the House nor the Senate generated a committee report on the legislation.

[4] "In concept, expenditures from the revolving fund generate receipts which, in turn, are earmarked for new expenditures, thereby making the Government activity a self-sustaining enterprise. The concept is aimed at selected Government programs in which a buyer/seller relationship exists to foster an awareness of receipts versus outlays through business-like programming, planning, and budgeting. Such a market atmosphere is intended to create incentives for customers and managers of revolving funds to protect their self-interest through cost control and economic restraint, similar to those that exist in the private business sector." Revolving Funds: Full

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funds are designed to collect funds from other agencies and accounts "to finance a continuing cycle of business-type operations." A Glossary of Terms Used in the Federal Budget Process (Exposure Draft), GAO/AFMD-2.1.1, at 5, Jan. 1993.[5]

Considering the FEDLINK statute, its legislative history, and the history of revolving funds generally, we believe it is instructive to look at how the private sector would deal with a contractor default. Generally, the default of a subcontractor or supplier is a "risk…allocated to the seller absent a specific provision to the contrary in the contract." *Barbarossa & Sons, Inc. v. Iten Chevrolet, Inc.* 265 N.W.2d 655, 659 (1978).[6] The failure of a contractor to perform is a "foreseeable" risk that the seller must be prepared to handle. Lee Russ, Annotation, *Impracticability of Performance of Sales Contract Under UCC § 2-615*, 55 A.L.R.5th 1 (1998). Under this approach, FEDLINK, like a seller in the private sector, should cover the losses sustained from RoweCom's bankruptcy, as there appears to be no basis under the interagency agreements for FEDLINK to allocate this loss to its customers.

The FEDLINK fund has two components: (1) advance payments made by agencies to cover their order for goods and services, which the Library refers to as "service dollars;" and (2) administrative fees to reimburse the Library for its administrative costs, both direct and indirect, of operating the program. B-288142, Sept. 6, 2001. Service dollars, as advances from customer agencies, are available to the Library only for defraying the direct cost of providing the customer's order. Id. They are not available to cover the losses incurred as a result of RoweCom's default. On the other hand, the administrative fees charged to each customer agency, which are based on a percentage of that customer's order, are used by the Library to fund the administrative and accounting staff and activities that support the FEDLINK program.[7] Additionally, the Library uses these fees to build a reserve in the revolving

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Disclosure Needed for Better Congressional Control, GAO/PAD-77-25, at 2, Aug. 30, 1977.

[5] See also Office of Management and Budget Circular A-11, § 20 (2003) (defining a revolving fund as "a fund that conducts continuing cycles of business-like activity, in which the fund charges for the sale of products or services and uses the proceeds to finance its spending").

[6] See also *Lambert v. City of Columbus*, 496 N.W.2d 540 (1993); *Center Garment Co., Inc. v. United Refrigerator Co.*, 341 N.E.2d 669 (1976); *Canadian Industrial Alcohol Co. v. Dunbar Molasses Co.*, 179 N.E. 383 (1932).

[7] We have long viewed it appropriate for agencies to assess administrative fees to other agencies in the course of providing goods and services, in order to recover overhead and other indirect costs. See 72 Comp. Gen 159 (1993); 38 Comp. Gen. 734 (1959); 22 Comp. Gen. 74 (1942).

fund to finance future improvements and to replace outdated equipment. Id. In our earlier FEDLINK decision, we endorsed the Library's decision to build a reserve in the revolving fund. We agreed that it was prudent for the Library to reserve some of the administrative fees, not spending all of them in the same fiscal year in which they were collected, so that they might be used for "legitimate business costs" which arise in subsequent years. Id.

We consider the losses associated with RoweCom's bankruptcy to be "legitimate business costs" of the FEDLINK fund. Therefore, the administrative fees the Library has collected and deposited in the revolving fund's administrative reserve are available to cover these losses. Faced with similar circumstances, a private business would have to absorb the losses resulting from a defaulting contractor. This conclusion is bolstered by the practices of several other federal revolving and franchise funds. An informal survey of several intragovernmental funds confirmed that there is an explicit agreement with the fund's customers or it is an accepted practice that the fund will bear any increased costs resulting from contractor defaults or other causes.[8]

CONCLUSION

The loss resulting from RoweCom's bankruptcy is related to the operation of the FEDLINK program, and is an appropriate expense of the revolving fund. The history of revolving funds in the federal government and the legislative history of the statute creating the FEDLINK fund reveal a clear intent for FEDLINK to operate similar to private enterprise. In the private sector, losses associated with a defaulting contractor are legitimate business costs of the enterprise, not costs to individual customers. The revolving fund, rather than the subscribing agency customers, should bear the loss associated with RoweCom's default, and the Library should utilize FEDLINK's administrative reserve to cover this deficit. If the Library wishes to allocate the costs differently in the future, it should add a clause dealing with contractor defaults to the interagency agreements.

Anthony H. Gamboa
General Counsel

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[8]Fund managers at the Departments of Treasury, Commerce, Interior, and Health and Human Services and the Environmental Protection Agency informally advised us that for each of their funds, if a situation arose where increased costs resulted from either a contractor default or unexpected expenses, the loss would be made up from the revolving fund's corpus, in the absence of a cost-reimbursable clause in its agreements with its customer agencies.