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LL. M. Thesis:  
Fiscal Law, Incremental Funding,  
and Conditional Contracts

By  
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ABSTRACT

Government Contract Law LL.M. Thesis

"Fiscal Law, Incremental Funding, and Conditional Contracts"

This thesis examines the effects of the uncertainties of the annual Budget formulation and review process and the legal limitations on the use of annual funds on Federal agency program planning and on various procurement techniques which have been evolved by the agencies to cope with these practical and legal limiting factors.

William Alton Hill Jr, Major, USAF

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**Fiscal Law, Incremental Funding,  
and Conditional Contracts**

By

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## FOREWORD

The author is an attorney serving in the United States Department of the Air Force Judge Advocate General's Department as a Judge Advocate Officer. He is presently assigned to the United States Air Force Academy, serving as an Assistant Professor of Law.

The views expressed in this thesis are solely those of the author. They do not purport to be the position of any agency of the United States Government.

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## Introduction

This thesis discusses problems caused in government procurement by the annual budget cycle, appropriations process, and the legal and policy limitations placed on the use of appropriations.

In particular, the limitations placed on the use of appropriations limit the most effective competitive procurement practices, because some potential suppliers hesitate to enter the government market for supplies and services or to commit capital because funding levels have been uncertain, and because economies of scale have often been unobtainable due to restrictions placed on the use of annual funds. These limitations also have hampered the effort of federal agencies to develop and retain suppliers, to foster competition to secure the lowest prices, to supply long leadtime items and to preserve the industrial base to meet mobilization needs.

This thesis is intended to develop the theoretical and practical interface between fiscal law principles and government procurement law principles. It discusses the contracting techniques the agencies have developed to cope

with the slowness and limited nature of appropriations, especially in cases in which agencies have real needs but either none or only part of the appropriations required to satisfy that need.

The processes and regulations of the Department of Defense and the United States Air Force have been emphasized throughout this effort, because they are of the greatest interest to this author and are most readily accessible to him. However, the subject matter is capable of generalization to all federal agencies and, in particular, the advent of the Federal Acquisition Regulations (FAR), the codification of Title 31, United States Code, and the occasional references to the regulations and cases of other agencies may make the work as a whole of interest to a class of readers reaching beyond the Department of Defense acquisition community.

The relationships between budgeting, funding and contracting techniques were investigated to attempt to discover the legal and policy constraints on the agencies' ability to rationally plan their activities and to allocate their resources. Since budgets are prepared annually, and obligational authority is provided most often to meet the needs of only the next budget year's approved requirements, certain questions naturally arose, and appeared to be central to this inquiry. Particularly, why contracts to satisfy

requirements are seldom funded incrementally, and why contracts conditional on the ultimate provision of obligational authority are not more often used. Incremental funding would appear to permit the greatest buying power from appropriations provided, and conditional contracts would appear to provide more continuity and certainty in program development and execution.

These questions could only meaningfully be addressed by developing a general understanding of the nature of the relationship between the Executive and Legislative Branches, and of the statutory and regulatory environment in which agency programs must be developed and executed.

**I. The Formulation of  
An Executive Agency Budget**

**A. The President's Budget**

**B. Budgeting in the Executive Agencies**

1. The PPBS Process

a. The Planning Phase

b. The Programming Phase

c. The Budgeting Phase

2. Management of Major Defense Systems:  
The DSARC

**C. Funding Types**

**D. Comments on Agency Budgeting**

## **Chapter I. The Formulation of An Executive Agency Budget**

To understand the need for the various contracting techniques which are the subject of Chapter V, the reader must possess some understanding of the impact of the budget formulation and review cycle, treated in this chapter, and of the congressional authorization and appropriation process, addressed in Chapter II, on the federal agencies' efforts to effectively procure the vast variety of goods and services necessary for the accomplishment of their missions within the substantive and procedural constraints of fiscal law principles.

### **A. The President's Budget**

The President has the responsibility to prepare budgets, and deficiency and supplemental appropriation requests.<sup>1</sup> Executive agencies are required to provide information required by the President.<sup>2</sup> He may change the "functional categories in the budget only in consultation with the Committees on Appropriations and on the Budget of both Houses of Congress."<sup>3</sup>

The budget is required to be submitted to the Congress during the first 15 days of each regular session, in January of each year, and the budget's minimum contents are extensively stated, including estimated expenditures and proposed appropriations to support the government in the budget fiscal year and the four fiscal years after that year, and estimated receipts for those five years; estimated appropriations, expenditures and receipts for the current fiscal year and the prior fiscal year and balanced statements of the Treasury's condition for the prior, the current and the budget fiscal year.<sup>4</sup> This budget statement must be updated throughout the year.<sup>5</sup>

The President must also submit to Congress by November 11 a statement of estimated budget outlays and proposed budget authority that would be required for the next fiscal year if the government's programs and activities were continued at the same level without policy change.<sup>6</sup> New authorization requests must be submitted before May 16 of the year before the fiscal year begins.<sup>7</sup>

The responsibility to develop, maintain, and publish standard budget terminology rests with the Comptroller General in cooperation with the Department of the Treasury and the Office of Management and Budget (OMB),<sup>8</sup> and the agencies are required to use these terms in providing fiscal, budget and



program information to Congress.<sup>9</sup>

The President's budget is required to include a statement of budget authority, proposed budget authority, budget outlays and proposed budget outlays, along with "descriptive information in terms of . . . a detailed structure of national needs that refers to the missions and programs of the agencies . . ., and . . . the missions and basic programs."<sup>10</sup> This has been variously referred to as a requirement for a "program" or "performance" budget.

The President's annual budget as a single, comprehensive compilation of the executive agencies' budget requests, is a relatively recent development -- it is a product of the Budget and Accounting Act of 1921.<sup>11</sup> Prior to 1921, executive agency budget requests were submitted to Congress in a book of estimates compiled from individual agency budget requests by the Secretary of the Treasury.<sup>12</sup> The annual budget is Congress' primary source of financial information concerning government operations, and the annual authorization and appropriation process is the Congress' major means of exercising oversight and control over Executive Branch operations. The President's Budget is the first step in the appropriations process. The appropriations process may be conceptually divided into four phases -- budget preparation and presentation, congressional authorization and

appropriation, budget execution, and audit -- although in practice the phases for various years overlap each other in an ongoing process of policy formation, implementation and review. The federal budget is the end product of planning, programming and budgeting efforts in each of the federal agencies, and of detailed review by and sometimes with the Office of Management and Budget (OMB), an office now placed within the Executive Office of the President.<sup>13</sup>

OMB succeeded the Bureau of the Budget (BOB), created by the Budget and Accounting Act of 1921. To aid the President in his task of producing a single comprehensive federal budget, BOB had been given power not only to assemble the budget requests of the agencies, but to change them, as well.<sup>14</sup>

### **B. Budgeting in the Executive Agencies**

The various agencies' budget requests are the products of lengthy internal processes of debate over national objectives and the evolution of programs to meet these objectives. Budgetary planning is increasingly a long-term process. In DOD, the integrated planning, programming and budgeting system (PPBS) begins over two years before the beginning and three years before the end of the budget fiscal year. Further, some of the larger procurement programs funded

as a result of this process will still have unexpended balances ten or more years later.

### 1. The PPBS Process

The integrated, iterative PPBS process was inaugurated in DOD in 1961. The process has proven capable of constant evolution to meet changing congressional demands and changing administrations' differing management emphases. The concept of program planning had long roots, and has since spread to other agencies.<sup>15</sup> In DOD, the initial process was overlaid with additions reflecting intervening administrations' management philosophies concerning the desirability of centralization or decentralization, detailed supervision of major weapons systems procurement, and short-term or long-term planning.

The final, objective manifestation of the successful competition of a program within the budgeting system of an agency is the ultimate provision by the Congress of "funds" sufficient in kind and amount to support that program -- that is, authority to obligate the Treasury to eventually pay out money to satisfy the obligations. This authority is discussed in terms of budget authority, outlays and total obligational authority:<sup>16</sup>

There are two concepts of the budget that apply to the whole Federal budget -- budget authority and outlays -- while a third concept -- total obligational authority (TOA) -- is applied only to the defense budget. TOA is the cost of the program presented to be approved by the Congress for the fiscal year. It is the concept of the budget that is used most widely by the DoD, by the Office of Management and Budget, and by the Armed Services and Appropriations Committees of the Congress in reviewing the defense budget. Budget authority is the authority to obligate the government (to contractors or to employees) to pay funds from the Treasury and is almost identical to TOA. Outlays are checks written on the Treasury to pay obligations of the government. It is outlays that are reviewed most closely by the Budget Committees and that appear as the main figure to be controlled in the Congressional Budget Resolution. While the Congressionally approved TOA and budget authority are legal limitations on obligating the government, outlays are predictions which may be higher than those approved by the Congress without violating the law.<sup>17</sup>

The term outlays thus generally represents actual expenditures of money from the Treasury. Outlays have a direct effect, of course, on the condition of the Treasury as well as on the overall economy, affecting inflation, interest rates, and employment through their effect on the amount of money in circulation. Congress' concern over outlays has led it to try to exert control over their rate by controlling budget authority, even though outlays generally lag the appropriation of budget authority by several years. The Treasury collects taxes and borrows money to meet outlay payments, not to meet the level of new obligational authority created by Congress each year.

Although Secretary of Defense Robert McNamara introduced program budgeting in 1961, the concept had been developed in the Rand Corporation during the 1950's, with its antecedent roots reaching far back into evolving concepts of business and public budget development and fiscal control. PPBS was introduced into DOD as a means of asserting the new Secretary's desired strong, centralized management over a department in which the various constituent military departments had previously developed and submitted their own budgets with DOD supervision largely limited to dividing DOD's budget ceiling among the departments.

The purpose of the PPBS is to identify urgent mission needs, and to allocate scarce budgetary resources among many programs competing to meet urgent national objectives by translating this allocation into budget proposals.<sup>18</sup> Not all can be satisfied or even undertaken at once and, as priorities change over time, some must be funded at the expense of others despite the sometimes high costs of such reprioritization. The PPBS is an institutional attempt to incorporate a systematic statement of the military threats to national interests throughout the world, strategies needed to counter those threats, the force requirements needed to effect those strategies, specific programs need to deliver the desired force levels and capabilities (desired "outputs"), and the funding levels ("inputs") necessary to achieve those stated

outputs.

The PPBS, in DOD, has been described as comprising five distinct steps designed to forecast as accurately as possible the inputs needed over the next five-year period covered by the Five Year Defense Plan (FYDP), to achieve specifically-stated output levels of defense capabilities: (1) in the planning phase, goals and objectives are defined, and forces or objectives expected to satisfy these national needs are defined; (2) in the programming phase, specific programs are adopted from among various competing alternatives (that is, desired outputs are established); (3) in the budgeting phase, required budgetary inputs are estimated for each program; and

The fourth step involves combining the DoD budget with the overall federal budget, a process in which the Office of Management and Budget (OMB) and various other executive branch individuals play key roles. This fourth step overlaps considerably with the third phase of the PPBS. In fact, the submission of the DoD portion of the President's budget is often seen as the conclusion of the PPBS process. From that point, however, the budget must still go through the fifth step, which consists of the several layers of ever-expanding Congressional review, authorization, and appropriation.<sup>19</sup>

Since this process requires about three years to accomplish from the start of service planning until budget execution actually is projected to begin on October 1 of any given fiscal year, and involves a "rolling update" of the FYDP

each year premised on each preceding year's actual funding levels, the administration's overall economic and fiscal policy for the budget year, as well as changing planning responses to changing threats, the PPBS cycle for any given year overlaps with and is directly affected by the current year's actual funding levels:

Since Congress enacted the FY 1984 appropriations legislation on November 18, 1983, two and a half months into the fiscal year, DoD was constrained to operate during that time under the restrictions of a continuing resolution. Because we did not know what the final FY 1984 budget would be, DoD was also constrained in its ability to develop the FY 1985 budget and the FY 1986-1990 plans.<sup>20</sup>

If budget enactment and execution activities are included, four cycles can be seen to overlap one another. Events in later stages of one year's budget can dramatically affect the development of budgets in earlier stages:

[A]ll the elements of the process interact non-sequentially and non-cyclically and provide both forward and retrospective effects on the process. . . . [T]he overall system is both cooperative and competitive and therefore entails accommodation of conflicting views and compromises resulting from overlapping, and sometimes ambiguous responsibilities and roles.<sup>21</sup>

In DOD, the PPBS is a constantly-evolving process that directly affects every aspect of agency operations. Under the present administration, the PPBS has been characterized by a return of budget execution authority and responsibility from

DOD to the services, an expansion of participants in the decision-making process to more fully include the views of the service chiefs and the unified and specified commanders, a continuation of DOD centralized policy direction, and an attempt to strengthen the planning phase of the process to achieve better long-range planning.

These goals have in part been achieved by expanding the charter of and membership in the Defense Resources Board (DRB) beyond the DOD Under and Assistant Secretaries and the JCS chairman envisioned when the DRB was formed in 1979. The DRB is the Secretary of Defense's program and budget corporate review body, chaired by the Deputy Secretary of Defense. Members now include the Chairman of the Joint Chiefs of Staff, the Service Secretaries, the Under Secretary of Defense for Policy (USD/P), the Under Secretary of Defense for Research and Engineering (USD/R&E), the Assistant Secretary of Defense (Comptroller), the General Counsel, and the Service Chiefs, who now attend virtually all DRB meetings. Other members include the Director of Defense Advanced Research Projects Agency (DARPA), the Assistant Secretary of Defense for Health Affairs, the Assistant Secretary of Defense for International Security Policy, the Assistant Secretary of Defense for Manpower, Reserve Affairs and Logistics, the Director of Program Analysis and Evaluation, and the Associate Director of the Office of Management and Budget (OMB). Others participate



as required to advise the DRB.

The unique direct participation of OMB in DOD program and budget reviews eliminates the need for a later formal OMB review and permits the submission of DOD's budget later than that of any other department. Current practice does not require a formal vote of DRB members and permits the Deputy Secretary of Defense to make most final decisions previously reserved for the Secretary of Defense.

The Five Year Defense Plan (FYDP) is one documentary product of the PPBS. The FYDP states all approved DOD programs, compiling the total resources -- forces, manpower, procurement, construction, research and development, and TOA -- programmed as required for DOD and its components' activities, arranged by Major Force Program (MFP) and appropriation. The FYDP projects these requirements five years into the future, except for forces data, which extend 8 years. Each service also projects future effects of current budget decisions for at least 10 years beyond the FYDP period in its Extended Planning Annex (EPA), and sometimes for longer periods in similar, but nonstandard, documents. The FYDP is maintained by the ASD (Comptroller), and updated three times each year.

The updates occur in January, to take into account the President's budget as submitted to the Congress and to provide a baseline for developing service programs for the next budget year; in May, to incorporate the services' Program Objective Memoranda (POM's), the first major step in developing the next DOD budget; and in September, to include the effects on the services' budget estimates of Secretarial decisions on alternative issues developed from the services' program proposals. In addition, there are many cross-year flows of financial and program direction used to evaluate, correct and redirect the process.<sup>22</sup>

The FYDP was developed to focus the PPBS by programs, or output-related functional categories, and to ensure a multi-year perspective for the system to facilitate and encourage longer-range planning beyond merely the next budget year.<sup>23</sup> DOD's budget was divided into ten Major Force Programs (MFP's) that still determine the FYDP's program element structure:

- Program 1: Strategic Forces
- Program 2: General Purpose Forces
- Program 3: Intelligence and Communications
- Program 4: Airlift and Sealift
- Program 5: Guard and Reserve Forces

Program 6: Research and Development

Program 7: Central Supply and Maintenance

Program 8: Training, Medical, Other General Personnel  
Activities

Program 9: Administration and Associated Activities

Program 10: Support of Other Nations

The FYDP's ten MFP's are each made up of hundreds of Program Elements (PE's), which are its basic "building blocks." Cross-service comparisons are facilitated by this subdivision of the major force programs into program elements. For example, all strategic weapons systems are identified within the MFP structure, Program 1: Strategic Forces. The Air Force's B-1 bomber is further identified in Subcategory 1, Strategic Offensive, and program element 121F designates requirements specific to the B-1 force, thus: P.E. 11121F. The input requirements of thousands of output-related program elements theoretically can thus be rationally related and aggregated ("cross-walked") into any desired combination through the PPBS, although the aggregation into the congressional input-related budget categories can create confusing program justification difficulties.<sup>24</sup>

Appropriations are broken down by major category with subsidiary fund accounts. For the Air Force, these include the Procurement appropriations (3010, Aircraft Procurement;

3020, Missile Procurement; 3080, Other Procurement); the Construction appropriations (3300, Military Construction; 3730, Military Construction Air Force Reserve; 3830, Military Construction Air National Guard; 0700, Family Housing); the Operation and Maintenance appropriations (3400, Air Force [subsidiary budget structure is the MFP/PE scheme used in the FYDP]; 0700, Family Housing; 1080, Military Assistance; 3740, Air Force Reserve; 3840, Air National Guard); the Military Personnel appropriations (3500, Air Force; 3700, Reserve Personnel Air Force; 3850, Air National Guard); the RDT&E appropriations (3600, Air Force).<sup>25</sup>

Program element data is managed by each the services' Program Element Monitors (PEM's), who are responsible for maintaining liaison between using commands and service headquarters, and for providing all needed information on the program elements assigned as the PPBS moves inexorably toward DOD's consolidated budget submission to OMB for inclusion into the federal budget each year.

The following brief description of each of the four PPBS phases illustrates the extremely technical and interrelated nature of federal agency program budgeting.

### a. The Planning Phase

The planning phase begins just as the programming phase for the next budget year ends, during congressional consideration of the Presidential budget for the current budget year, during execution of the current fiscal year's budget. The documentary product of the planning phase is the Defense Guidance (DG). The DG is prepared by the Under Secretary of Defense, assisted by the DG Steering Group. It is the primary statement of national security objectives which DOD programs must be designed to achieve as fully as possible under existing fiscal constraints. This document includes intelligence from the intelligence agencies and the National Security Council, as well as inputs from the Joint Chiefs of Staff and the Commanders-in-Chief of the Unified and Specified Commands. The DG is thus the DOD components' "touchstone" for the remainder of the budget cycle, stating the Secretary of Defense's policy, strategy, force planning, resource planning, and fiscal guidance. The final DG is issued in late January or early February.

For the President's FY 1985 budget, service planners actually began work in August of 1981, providing inputs to the Joint Strategic Planning Document (JSPD) and the Defense Guidance (DG), as the annual results of a lengthy, detailed dialogue. The internal Air Force planning process includes

the Global Assessment and the Planning Guidance Memorandum. Another resulting document, the Strategy and Policy Assessment provides the basis for the Air Force input to the JSPD and the DG. A process called Mission Area Analysis provides an assessment of Air Force mission capabilities and a basis for programmers to evaluate various competing alternative means of satisfying mission needs. This annual process results in the Air Force Planning Guide which states the Air Force force structure believed necessary to execute the Air Force's role in the national military strategy. Another document, the Planning Input for Program Development (PIPD) prioritizes these needs. The other services go through a similar process.

Mission Area Analysis (MAA) is partly the result of the Congressional Budget Impoundment Control Act of 1974 and OMB Circular A-109 which together require that budgets be presented to the Congress along mission lines, and weapons systems developed only after mission needs analysis. The Air Force provides Mission Area Analysis for the entire Air Force program.

#### **b. The Programming Phase**

In May, DOD components submit their Program Objective Memoranda (POM's) proposing programs both meeting DOD mid-range (five-year) objectives and designed to be

"affordable," that is, to fit within the projected DOD budget. The POM's are the services' efforts to prioritize fiscally-constrained program proposals for the next five years.

The programming phase applies fiscal constraints to the many competing requirements of the Services. This phase begins before the planning process finishes and does not end until after the beginning of the budgeting phase. The POM is based on service planning data, the POM submissions of the operating commands and agencies and direct reporting units, as constrained by the DOD DG. Each POM takes some six months to develop, a period of intense internal advocacy. Within the Air Force, the Director of Programs and Evaluation (AF/PRP) has responsibility for constructing and defending the annual POM. More than 400 Program Element Monitors (PEM's), representing the Air Force's more than 600 PE's, have inputs -- and both Air Staff functional area staff and the Major Commands advocate their existing programs and desired new initiatives. The Major Commands review the POM during its development.

Within each DOD component's POM, a great share is considered "core," or not readily variable if essential levels of military readiness and combat sustainability, as well as the necessary support activities, are to be delivered as

needed. Only a small portion of DOD TOA allocated to Air Force activities is available in any budget year to support new initiatives designed to deliver increased levels of present force growth, modernization, research and development, readiness and sustainability and support. Inevitably, each year some balance must be struck between these competing concerns.

POM review includes a risk assessment of the POM as proposed by the Joint Staff, resulting in the Joint Program Assessment Memorandum (JPAM).

DOD components' POM's are then subjected to the program review process under the leadership of the DOD Comptroller and the Program Analysis and Evaluation Directorate. Issue papers are the documentary result, highlighting key issues concerning compliance with the DG and perceived improvement alternatives. The issue papers are staff studied, then consolidated into eight issue books covering policy and risk assessment, nuclear forces, conventional forces, modernization and investment, readiness and other logistics, manpower, intelligence, and management initiatives.<sup>26</sup>

In July-August, the Defense Resources Board (DRB) makes these key policy decisions and issues them as Program



Decision Memoranda (PDM's) directed to each service. The POM's, modified by the PDM's, constitute the "baseline" for the subsequent budgeting phase.

Meanwhile, the POM's for the following budget year are beginning to be developed.

During the latter part of each calendar year, the POM's are updated, often as a result of congressional review actions on the President's Budget for the preceding year. Service operating commands, agencies and direct reporting units use their service's budget estimate submission (BES), which is available in September, as their initial baseline to gauge resources likely to be available for the next budget year -- the true baseline, the President's Budget, will not be available until January. Still, services must begin POM input development in the Fall to meet OSD's service POM submission deadline in mid-May. In the Air Force, Program Decision Packages (PDP's) are used as a mechanism to manage PE's during their internal review through the Air Force Board structure -- the Air Force's corporate review body, used to integrate and oversee the POM development process and to make adjustments to accommodate funding shortfalls. Program funding must be revised --sometimes reduced, rephased or cancelled -- as more definite data is obtained. Only after the new baseline is fixed in January, with the submission of the President's

Budget which establishes the first year of the FYDP, may new initiatives be proposed through the Air Force Board structure.

The developing POM is reviewed and adjusted as the year progresses, in a series of "program exercises," designed to test the accuracy of program costing and to achieve the three FYDP updates accomplished each year. The "A" exercise occurs in March-April and initially costs the programs and alternatives proposed; the "B" exercise, occurring in August-September, revises program costing and incorporates changes directed during program review in PDM's, resulting in the services' budget estimate submission (BES); the "C" exercise occurs in October-December and includes changes directed in budget review mandated by Program Budget Decisions (PBD's) which are the result of the DOD/OMB budget review process that completes the DOD budget development cycle.

### **c. The Budgeting Phase**

In September, the service/OSD dialogue shifts from the respective programming staffs to the comptroller staffs. DOD components submit budget estimates (BES's) based on their POM's as amended by the PDM's. These some 22 budget submissions are then examined by the DOD Comptroller during the next three months "for accuracy of pricing, producibility, feasibility, scheduling, and consistency with established

policies and previous decisions. The budget review is considerably more detailed than the program review and concentrates primarily on the budget year to be presented to Congress."<sup>27</sup>

The budget review involves hearings conducted by OSD, in which OMB participates in an advisory capacity. OMB coordinates on the resulting documents, the Program Budget Decisions (PBD's), which resolve most differences between the BES and the OSD/OMB pricing determinations. The services may appeal PBD's through reclaims.

In November-December, the Secretary of Defense resolves remaining major policy decisions which inevitably arise as consequences of congressional review of the budget submitted in January and of the President's "target topline" issued to DOD for the next budget year.<sup>28</sup>

By late December, the DOD budget is integrated with the budget for the rest of the executive agencies. When OMB revises its government-wide economic assumptions, rushed changes have been required to bring DOD' intricate budget into balance.

After the President has approved the final DoD budget, and OMB has incorporated it into the national budget, the process begins to move into the fifth stage, the Congressional review process. In

preparation, DoD provides exhibits and narrative to OMB for printing in the federal budget and for submission to the Congress in late January. In addition, DoD begins preparing Congressional justification documents, testimony for the Secretary and other DoD witnesses, and various supporting documents in support of the budget. Last year, for example, more than 21,000 pages of documents and exhibits were prepared for these Congressional presentations.

As soon as the national budget is sent to Congress, literally the next day, the Secretary of Defense begins his presentations in justification of that budget to the House and Senate committees on Armed Services, Appropriations, and Budget.<sup>29</sup>

It should be apparent that one consequence of the intricate PPBS process is that a new administration will be constrained by its predecessor's Defense Guidance (DG) that was issued the preceding summer-- and its related PPBS cycle and resulting budget. Another consequence is that the press of gathering and reviewing and justifying budget data tends to limit the amount of time available for accurate data collection and for analysis of that data.<sup>30</sup>

## **2. Management of Major Defense Systems: The DSARC**

Major weapons systems procurement is managed not only under the PPBS -- as are all other parts of DOD's budget -- but these large, expensive procurements also receive the special scrutiny of the Defense Systems Acquisition Review Council (DSARC), as well as the individual services' Systems Acquisition Review Councils (SARC's).

One means of coordinating major systems acquisition with the PPBS has been ensuring the overlapping membership of the DSARC and the DRB. DSARC membership includes many of the members of the DRB, which supervises OSD review of the service POM's and budget submissions: the Defense Acquisition Executive (DAE) and Chairman of the DSARC is the Under Secretary of Defense (Research and Engineering); other members are the Under Secretary of Defense (Policy), Assistant Secretary of Defense (Comptroller), Assistant Secretary of Defense (Manpower, Reserve Affairs and Logistics), Director of Program Analysis and Evaluation, Chairman of the Joint Chiefs of Staff, and the Service Secretaries (when their services' programs are involved). DOD also has sought to ensure that the two management review processes are more closely coordinated by requiring all proposed major systems new starts to be fully integrated, justified and budgeted in the services' POM's, and proposed new starts also are considered during the POM review process.

The DSARC was established in 1969 within the Office of the Secretary of Defense (OSD) to attempt to ensure that major defense systems were not moved toward production before proving their readiness.<sup>31</sup> The life-cycle phases of major defense systems are (a) concept exploration, (b) demonstration and validation, (c) full-scale development, and (d) production

and deployment. The DSARC was to be chaired by the Director of Defense Research and Engineering (DDR&E), and a directive was promulgated in 1971 to govern the acquisition of major defense systems.<sup>32</sup> Life-cycle phases were separated and sometimes interspersed by development "milestones," the number of which varied to reflect different administrations' varying management philosophies. At milestones, the Secretary of Defense -- advised by the DSARC -- retained decision authority.

Milestone 0 began the concept exploration phase, during which alternatives were considered; Milestone I began the demonstration and validation phase with selection of an alternative; Milestone II began the full-scale development phase with a secretarial decision to deploy the system; and Milestone III began the production and deployment phase. Over the years, like the PPBS process, the DSARC reviews and their associated required documentation were changed and sometimes elaborated to reflect the various administrations' management styles and to react to political pressures:

[T]he late 1950s and 1960s were characterized by centralized control at the OSD level, by overreaction to the management problems, by procedures and regulations that were too detailed, by multitudinous paper studies to determine risks (rather than by hardware testing), by management theories that were too often in conflict with real-life practices, and by growing industry frustrations.<sup>33</sup>

By 1976, the Office of Management and Budget (OMB), in its OMB Circular A-109, defined a "major system" as:

that combination of elements that will function together to produce the capabilities required to fulfill a mission need. The elements may include, for example, hardware, equipment, software, construction, or other improvements on real property. Major system acquisition programs are those programs that (1) are directed at and critical to fulfilling an agency mission, (2) entail the allocation of relatively large resources, and (3) warrant special management attention. Additional criteria and relative dollar thresholds for the determination of agency programs to be considered major systems under the purview of this Circular, may be established at the discretion of the agency head.<sup>34</sup>

In addition, DOD established several other criteria to be considered before a proposed major system would be subjected to the DSARC management process:

- (1) Development risk, urgency of need, or other items of interest to [the Secretary of Defense];
- (2) Joint acquisition of a system by the DOD and representatives of another nation or by two or more DOD components;
- (3) The estimated requirement for the system's research, development, test, and evaluation (RDT&E), and procurement (production) funds;
- (4) The estimated requirement for manpower to operate, maintain, and support the system in the field;
- (5) Congressional interest.<sup>35</sup>

Defense programs were designated as "major," if dollar cost thresholds were exceeded, or if programs were designated

by the Secretary of Defense as of such importance and priority that they required DSARC attention. The dollar thresholds were \$100 million for RDT&E, or \$500 million for procurement (production).<sup>36</sup>

These dollar thresholds and the effect of recent rapid inflation, resulted in so many programs being subjected to DSARC supervision that the DSARC's ability to function effectively was degraded. In 1982, DOD Directive 5000.1 was changed to raise the thresholds to \$200 million for RDT&E, and \$1 billion for procurement programs. This change immediately resulted in a reduction of the list of major programs from 52 to 42, thus decentralizing management control over the deleted programs and permitting the DSARC to focus more deliberately on truly major programs.

Many criticisms have been aimed at the major program acquisition process, such as this comment in the Report of the Acquisition Cycle Task Force, which was chaired by the present USD(R&E), Dr. Richard DeLauer:

Lack of realism in estimation of program costs, changes in specified performance requirements, inflation, and other such causes of 'cost growth' have caused the aggregate cost of planned production programs to substantially exceed the allocated budgetary resources, resulting in the need to delay the completion of the production phase of programs in order to fit the total available defense budget in each fiscal year. The 'bow wave' effect created by too many programs in full-scale



development at any given time in relation to the available production funds results in an acquisition cycle for the typical defense system which is [i]n excess of the optimum length of time and is more costly than planned or estimated.<sup>37</sup>

The PPBS and DSARC processes together have been criticized for their tendencies to spread available funds too thinly over too many programs, producing low, inefficient rates of production. This phenomenon is called the "bow wave" effect:

The Bow wave is . . . a complex interaction of forces. It starts with very high-cost, high-technology systems, and a demand for inventory which exceeds available funds. It becomes aggravated by increased costs for the systems (relative to their development estimates) as changes are made, better estimates reveal actual cost more accurately, and higher than expected inflation occurs. The acquisition approach then slows down the planned production rate, while adding to each program's total cost and lengthening its out-year demand for funds. The projected funds needs thus are pushed higher and higher in future years owing to the stretch-outs and entrance into production of yet more systems.<sup>38</sup>

It has been suggested that the bow wave effect could be managed by a budget increase, reducing new system starts, and holding systems presently in production more closely to their projected costs.<sup>39</sup>

These aggregated problems degraded the system's effectiveness, especially when aggravated by the recurrent lateness of DOD's appropriations acts each year:

Moving a request through governmental machinery is considered to be the single, most time-consuming task at all levels of management concerned with new weapons. Testimony indicated that it can take up to five years to get a new project approved, including up to two years to go through the budget review process, as OSD and the military departments work to handle three budgets (current, next year, and future) simultaneously each year. In recent years, the military departments have been four to six months into the fiscal year for which funds were appropriated before the appropriations were approved by Congress. When this is contrasted with a contracting cycle requiring an average of eight months for a major procurement, it is obvious that problems will arise when action is taken to compress much of the contracting into the last six months of the year. This fiscal year time compression is felt in every aspect and at every level of the DOD PPBS.<sup>40</sup>

Needs for new acquisition programs are stated by the services in their POM's. "Major" acquisition programs -- falling under the management supervision of the DSARC -- begin to undergo the DSARC's scrutiny with required special need justification statements, formerly called mission element need statements (MENS), now called Justification for Major System New Starts (JMSNS), to support the initial milestone decision. While detailed review of a program's funding needs remains with the DRB, services must now also assure the DSARC that their major systems can be executed as planned with resources stated in the FYDP. This requires preparation and coordination of the JMSNS and the service POM to achieve DOD authorization to start a new program.

The DSARC process recently has been further improved by reducing the number of formal OSD reviews from three to two, and the number of Secretary of Defense decisions required from four to two. Now, the Secretary maintains indirect control over new program initiation (formerly provided by Milestone 0) through the JMSNS and PPBS, and over the decision to enter production by requiring the production phase to adhere to the plan approved by the DSARC, as well as through his expressly-reserved power to hold special program reviews. The production decision has been delegated to DOD component heads, who are encouraged to redelegate to the lowest administrative level having a comprehensive view of the program.

Explicit Secretarial decisions are now required only at the Milestone I and II points, now called Requirement Validation and Program Go-Ahead, respectively. This decentralization gives new emphasis and authority to service and program manager management responsibility. Documentation requirements have also been reduced, by eliminating the mission need determination from DSARC reconsideration and leaving it in the PPBS review process, and substituting a system concept paper (SCP) for the formerly-required decision coordinating paper (DCP), the integrated program summary (IPS), and the milestone reference file (MRF). The SCP includes the results of the concept evaluation phase, states

objectives for the next program milestone, a recommended acquisition strategy, and a "not to exceed" dollar ceiling expected to reach the program go-ahead point. These changes were designed primarily to achieve coordination of the DSARC and PPBS processes, improved DOD management of major programs, greater service and program manager initiative and authority, and faster and less expensive development and procurement of major defense systems.

### C. Funding Types

Despite the Congress' prevalent annual funding practice, much unspent budget authority is carried over from prior years. Little of these unexpended balances are available for new programs, however, because under fiscal law principles either express or implied authority limitations of appropriations for particular stated purposes prevent their obligation for any other purposes. One major cause of unexpended appropriation balances is the required full funding of procurement programs for the full cost of annual requirements, even though obligation and outlays often occur over a period of several years.

At this point, it may be useful to compare traditional single-year contracting to multi-year contracting to introduce key fiscal law and budget terms.<sup>41</sup>

Under traditional annual procurement methods, total quantity of desired completed end-items will be divided into stated annual quantities called annual "requirements," because the total quantity of end-items will not all be needed in one year. For major procurements, requirements will be stated for several years within the service's POM and, if approved by the Secretary of Defense, annual requirements will be stated for several years of the FYDP. The rate of desired delivery -- each year's stated "requirement" within the FYDP -- will be determined by factors such as the service's ability and need to absorb the equipment and the projected availability of appropriations. Hence, the term "requirement" is basically a programming concept that reflects the competition between programs for funds.

The total program "buy" thus includes the sum of all years' requirements (the individual years' "buys"), but the President's Budget will present the Congress with a request for only the first year's requirement. If the Congress appropriates funds for all that year's requirement, it will have "fully funded" delivery of that year's stated quantity of complete, usable end items by providing the authority to obligate the United States to ultimately make a disbursement in that amount .

Funds provided under a procurement appropriation are "multiple-year funds" because Procurement title funds are generally provided with a stated time limitation of three years in which to obligate those funds for the purposes stated. If all that authority is exercised within that time by entering into valid, binding obligations, none of those appropriated funds will lapse and expenditures may ultimately be made to satisfy those obligations. Note that multiple-year appropriations are provided to satisfy the single year's "requirement" stated in the budget and none other, and a large unobligated balance may be carried from the current fiscal year forward. This is a reflection of the reality that procurement of complex items nearly always requires more than a single year to accomplish: Requests for Proposals (RFP's) or Invitations for Bids (IFB's) must be prepared and the responses compared in competitive procurements, and end items cannot be assembled for delivery until components requiring significantly longer leadtime than the end item itself are first secured and other materials are obtained and fabricated.

The resulting contract will be a single-year contract because it is intended to satisfy only one year's requirement, even though these appropriated funds may not be completely obligated for three years after appropriation and the completed end items may not be delivered and paid for until several more years pass. Actual outlays (expenditures) of the

appropriated amount may lag the appropriation by five or more years. Delivery time for subsequent years' requirements may be shortened by use of "advance long leadtime procurements," a limited exception to the policy requiring full funding of procurement activities.

Procurements of other than major weapons systems generally have been procured through recompetition of each year's budgeted requirement; major systems usually have been procured through a single source one-year production contract with a series of options for subsequent years' requirements. Either way, each year's requirements will be subjected to the annual authorization-appropriation process, with all its attendant uncertainties.

Single-year contracting is often said to be "flexible" because the government commits itself contractually to buy only part (one year's requirement) of the total buy of the end item concerned in any fiscal year. Further, single-year contracts can be unilaterally ended before performance is completed by the government under the contract's Termination for Convenience clauses, which provide that the government will pay terminated contractors their allowable costs of performance up to the time of termination, plus reasonable costs of termination, but no payment will be made for the contractor's anticipated (but unearned) profit or for his

nonrecurring, initial startup costs which he might have hoped to amortize over the life of the contract and expected follow-on contracts (for subsequent years' requirements for the end item). The maximum potential cost to the government to terminate an annual contract for convenience is called the "termination liability" and the actual cost is called the "termination charge."

Single-year contracting may be the most expensive form of contracting, because prudent contractors must attempt to recover such costs in a contingency factor applied to the first year's unit prices, making the first year of performance more expensive than would be likely if the government were able to enter into more stable, multi-year contracts providing the contractor more insulation from the risk of termination or cancellation, thus avoiding imposing on the contractor the risk of closing both his contract and his investment in sometimes specialized, and otherwise unusable, startup expenses. Multi-year contracting does this through its contractual provision for "cancellation liability."

The Federal Acquisition Regulation multi-year contract differs from single-year contracting in that it provides a definite government commitment to purchase more than one year's, but fewer than five year's, requirements as stated in the FYDP subject to possible unilateral government



cancellation, which entails execution of the government's promise to pay a cancellation charge that will reduce the contractor's financial risk below the level of exposure he would bear with a single-year contract. A multi-year contract's commitment to purchase future years' requirements is contingent upon the subsequent provision of adequate, available appropriations. Complete failure to fund a future year's scheduled quantity will result in total cancellation of the contract and incurrence of the cancellation liability, producing a cancellation charge, while a partial reduction in any year's requirement will be handled as a termination for convenience.

Like single-year contracts, funds for multi-year contracts' scheduled annual requirements are appropriated annually, and the provision of funds is not certain. While funds appropriated also will be multi-year procurement funds, they are not an example of "multiyear funding." Multiyear funding refers to the appropriation of funds for more than one year's requirements at one time. The Congress seldom uses multiyear funding, largely because to do so would diminish policy formulation flexibility and its ability to use the annual budget cycle to control Executive Branch operations.

Multi-year contracting, and recent Executive Branch initiatives seeking authority to expand multi-year

contracting, will be discussed more fully in Chapters IV and V.

#### **D. Comments on Agency Budgeting**

Just as there is a constant tension between flexibility and stability in agency budgeting, there also has been a tension between the virtues of centralized decision-making in resource allocation and the virtues of diversity and decentralization.

The use of program budgeting in DOD has been both evidence of, and an instrument for achieving, greater centralization in resource allocation decision-making. This trend has its foundation in the National Security Act of 1947, which placed all defense activities under a Secretary of Defense, and the creation of the Department of Defense in 1949, which ended the various armed services' status as separate executive departments. Within DOD, the position of Director of Defense, Research and Engineering (DDR&E) was created in 1958 to coordinate technical roles and missions among the services.<sup>42</sup>

The budget process in DOD has oscillated between an emphasis on centralized civilian control and decision-making, and an emphasis on decentralized control giving more

discretion to military management. From 1947 to 1961, decentralization was the rule. During those years, DOD received a specified share of the total federal budget -- under President Truman, one-third of the federal budget and, under President Eisenhower, 10 per cent of GNP -- and DOD retained a measure of control over the services by allocating this sum among them. This period was marked by poor resource allocation: "[D]uring the 1950's the Department of Defense was simultaneously developing a dozen intercontinental ballistic missile systems, but had almost no air or sealift programs."<sup>43</sup>

During the 1961-1969 period, Secretary of Defense McNamara introduced PPBS to DOD and used it as a means to achieve strong management centralization: "The services merely executed the detailed programmatic guidance laid down by the secretary [of the Defense Department]."<sup>44</sup> During the Nixon-Ford administrations, Secretary Laird relaxed this centralization and permitted the services to function within broad general guidelines. President Carter's Secretary of Defense Brown also heavily centralized program control. Over the years, the overlaying of these differing management philosophies resulted in an unwieldy, paper-burdened system.

Secretary Weinberger directed an analysis of the functioning of both PPBS and the major systems acquisition process immediately upon assuming control.<sup>45</sup> He has acted to

again relax the DOD PPBS system, and to reduce its burdensome paperwork. In doing so, he directed the retention of centralized policy control in the Office of the Secretary of Defense, but the decentralization of operational control to the services. "Zero Based Budgeting" (ZBB), an innovation of the Carter-Brown period which featured annual rejustification of every program and a consequent tripling of report requirements, was largely dropped as a failure, retaining only the concept of prioritizing programs at the margin, thus greatly reducing the paperwork requirements of the PPBS. The planning phase and the role of the JCS was strengthened.

During the budgeting phase, the stability of programs was often disrupted by reprioritization and "revisitation" decisions made during the programming phase:

[T]here were 160 priority changes in the FY 1982 budget phase for programs that had been 'decided' in the programming phase. In the Navy shipbuilding program, which by its nature should be long-term and stable, major initiatives were alternatively inserted and later dropped out as the cycle progressed. Over the many months required to reach a decision, all of the reviews and analyses by the various technical and contract offices were redone repeatedly. Tough decisions were normally postponed until the final days of the cycle.<sup>46</sup>

At the end of the budgeting phase, Presidential decisions on fiscal levels and programs produced sudden changes in budget estimates and programs -- known as "tail-end perturbations."<sup>47</sup> Also at the end of the budgeting phase,

translation of the DOD budget into congressional appropriations categories can produce undesired results: "[J]ustification of the congressional categories was sometimes allowed to drive programmatic decisions. For example, holding down a line item of particular interest to Congress, like travel, stretched out a program like the F-15 aircraft which [might have] required travel funds to train pilots."<sup>48</sup>

On the other hand, the DOD procurement decision-making processes also have been criticized because the size and complexity of the system result in decisions both difficult to make and difficult to stop or change. In reality, the Congress seems to have only a limited ability to control either the size of the federal budget or the DOD portion of that budget. Changes of any size require major reprioritizations in affected agencies, so that even a one-year appropriation, in practice, may foreshadow a long-term commitment. This combination of circumstances tends to make decisions "practically" irrevocable without insulating them from the burdens of continual reexamination.

One commentator attributes this effect largely to three forces at work in the overall decision-making process. The first is the momentum achieved by programs once initiated, even though the decisions to proceed must often be made in a climate of great uncertainty. Decisions, once made in the

agencies, are vigorously defended before congressional committees by agency officials. The second is the tendency of the internal DOD decision-making process to overestimate program performance and to underestimate program costs. This produces a tendency by lower levels to defend program funding by minimizing program problems and underestimating costs, and leads to a cyclical tightening of control and increasing of reviews and reports. The third is the sheer size and complexity of many procurement programs which tend to limit the field of potential competitors, leading to a severe limitation on the range of agency and congressional actions.<sup>49</sup>

The DOD budget, like the federal budget generally, increasingly permits little leeway for achieving short-term savings in outlays. This is due to the increased emphasis on force modernization, which has raised the procurement share of the budget from 25 per cent in 1980 to 35 per cent in 1983, with a 40 per cent share planned by 1988.<sup>50</sup> There are wide swings in the rate of outlays between years in different defense procurement programs depending on their nature -- but the overall results of a growing procurement share are to force growing percentages of planned outlays to later years, and to tie larger percentages of outlays in later years to prior-year programs. This reduces congressional flexibility in reducing outlays in future years:

Cuts in outlays in a proposed budget must be sought in three categories: pay and other operations, current investments, or prior-year programs. The first category, which made up 63 per cent of the budget in 1980 and will represent 46 per cent in 1988, translates into force levels, readiness or sustainability -- matters not easily tampered with. Reducing outlays in the second category, investments, actually means much larger budget slashes: in the extreme, for example, cutting the 14 per cent of the outlays generated by current investment TOA in the 1984 budget would require eliminating all procurement, R & D and construction programs, or about 47 per cent of the TOA budget. Another possibility would be cutting outlays generated from prior-year investment programs. This would entail -- with few exceptions -- scrapping partially built weapons as well as incurring large termination payments. The latter would, of course, offset much of the savings."<sup>51</sup>

The internal DOD resource allocation process is in a continual state of change, as problems are perceived and improvements proposed. Among these are the proposal to combine the programming and budget phases into a single integrated cycle to permit more time to be devoted to long-range planning; to experiment with biennial budgeting within DOD; to pursue possible procurement economies recently permitted by the Congress to encourage use of enhanced multi-year procurement and more stable, economic production rates, and to increase investment, competition and dual-source production.<sup>52</sup>

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## Chapter I: Footnotes

1. 31 U.S.C. §§ 1104, 1107.
2. 31 U.S.C. § 1108.
3. 31 U.S.C. § 1104 (c).
4. 31 U.S.C. § 1105. But see S. J. Res. 6, Pub. L. No 99-1, 99 Stat. 3, January 9, 1985, extending times for the FY 1986 Budget Message and associated reports.
5. 31 U.S.C. § 1106.
6. 31 U.S.C. § 1109.
7. 31 U.S.C. § 1110.
8. 31 U.S.C. § 1112.
9. 31 U.S.C. § 1112 (d)&(e).
10. 31 U.S.C. § 1105 (22).
11. Budget and Accounting Act, Act of June 10, 1921, ch. 18, 42 Stat. 20.

12. See generally, Gallimore, Legal Aspects of Funding Department of the Army Procurements, 67 Mil. L. Rev. 88-97 (1975).

13. Reorganization Plan No. 2 of 1970, Pt. I, reprinted as note to 31 U.S.C.A. § 501.

14. Budget and Accounting Act, Act of June 10, 1921, Chap. 18, § 207, 42 Stat. 22, codified at 31 U.S.C. § 501-522.

15. See Bradley, "Program Budgeting," RAND Report No. 3859 (1968); Novick, "Long-Range Planning Through Program Budgeting," RAND Report No. 3850 (1968). The General Motors Corporation made one of the first uses of a program budgeting system in the private sector occurred in the 1920's. Bradley, "Program Budgeting" supra at 8. See also Steiner, "Problems in Implementing Program Budgeting," RAND Memorandum No. RM-4514-RC (1965); McKean & Anshen, "Problems, Limitations, and Risks of the Program Budget," RAND Memorandum No. RM-4377-RC (1965); Smithies, "A Conceptual Framework for the Program Budget," RAND Memorandum No. RM-4271-RC (1964); Novick, "Program Budgeting: Long-Range Planning in the Department of Defense," RAND Memorandum No. RM-3359-ASDC (1962).

Although there were earlier uses of elements of program budgeting in the federal government, the 1949 Commission on Organization of the Executive Branch of the Government (the Hoover Commission) gave the concept its first consistent formulation. The Commission's recommendation of a "performance budget" for the federal government based on output-related categories of functions, activities and projects, and the 1949 amendments to the National Security Act of 1947 provided for performance budgeting in DOD. The new "performance" budget adopted the appropriations categories now in use: Military Personnel; Operation and Maintenance; Procurement; Military Construction; and Research, Development, Test and Evaluation. Formerly, the services each developed and presented their budgets individually, divided and prepared by their technical services: the Army prepared budgets for its constituent elements, such as its Quartermaster Service, Transportation Service, and Ordnance Service. Neither system permitted input units to be compared to alternative expected output units, because neither related the budget to national defense strategy objectives. Smithies, supra at 11.

In 1955, the report of the Second Hoover Commission reiterated this recommendation, changing the concept's name to "program" budgeting. Steiner, supra at 7. But the reform has not yet reached the Congress, despite many efforts to change its budgetary process. The Congress' budget remains based on

input-related appropriation categories. See Steiner, *supra* at 10. Problems of budget translation between an output-related program budget and an input-related congressional budgetary process were foreseen, as was the usefulness of an annual budget cycle in disciplining the creation of the program budget:

With the two structures, however, there will develop large amounts of paper work, conflicts between program decisions and decisions about input categories, and difficulty in gearing the new system to an annual budget cycle. The nature of the paperwork is obvious, although people are likely to underestimate its extent. Conflicts between program decisions and input cuts may need explanation. As long as some decisions are made in terms of specific input categories, cutting across program elements, they can on occasion disrupt the program budget system, vitiate particular program change decisions, and cause considerable confusion.

Moreover, the possibility of such conflicts makes it desirable to gear the new system rather closely to the annual budget cycle. Other considerations also make this desirable. In principle it would be convenient to let the budget be altered at any time and to eschew any budget ceilings or deadlines. In fact, however, there is an annual cycle (Congress is not about to authorize two-year budgets), and one should have cut-off dates and at least ball-park ceilings for the program budget as well as for the old style budget. Indeed, adjusting to the annual cycle and keeping it an orderly one may be the only way to preserve any energy and time for a serious look at the program years.

McKean & Anshen, *supra* at 10.

In DOD, program budgeting was encouraged by the lessening relevance of the natures of the military services'

role distinctions as exclusive, independent means of accomplishing particular functional missions, and this growing service interdependence was accompanied by the increasing cost of defense systems and the annual budget's diminishing value as a tool for managing large, complex, acquisition programs extending over several years. See Novick, "Program Budgeting: Long-Range Planning in the Department of Defense," supra at 2. During the years between 1955 to 1961, the concept became more widely accepted both in private and public fiscal planning. In 1965, the Bureau of the Budget required 22 agencies to adopt the PPBS. BOB Bulletin No. 66-3 (October 12, 1965). The program budgeting concept has proved capable of flexibility in meeting the needs of varying users. See, e.g., Gremillion, McKenney & Pyburn, Program Planning in the National Forest System, Pub. Admin. Rev. 226 (May/June, 1980).

The Planning, Programming, Budgeting System as instituted in DOD in 1961, features several major elements:

(1) a program structure in terms of missions, forces, and weapons systems; (2) the analytical comparisons of alternatives; (3) a continually updated five-year force structure and financial program; (4) related year-round decision-making on new programs and changes; and (5) progress reporting to test the validity and administration of the plan. . . . With the establishment of this system the need has been reduced considerably for what Secretary McNamara has called 'hectic and hurried' decisions on major programs in the course of budget review. The annual budget now is essentially an increment of a longer-range plan.

Novick, "Program Budgeting: Long-Range Planning in the Department of Defense," supra at 3. The longer time horizon of the PPBS was seen as a means of revealing the full costs of new programs, and preventing "camel's nose tactics in winning support for proposals by publicizing relatively modest entrance expenses." Novick, supra at 21. Full costing of proposals and alternatives, and explicit treatment of uncertainties have been concerns surrounding the usefulness of programmatic comparisons from the early years of the program budget concept. See, e.g, Novick supra at 7.

16. Kanter, The 1984-1988 Defense Program: The Debate Continues, Strategic Review 36 n.1 (Spring, 1983).

17. Id.

18. See generally, Puritano, Resource Allocation in the Department of Defense, 29 Armed Forces Comptroller 4 (1984); Air Force Directorate of Programs and Evaluations (AF/PRP), The Planning, Programming and Budgeting System (PPBS) -- A Primer (4th Ed., December, 1983); Joint DOD/GAO Working Group on PPBS, The Department of Defense's Planning, Programming, and Budgeting System, GAO/OACG-84-5 (September, 1983), hereafter cited as DOD/GAO PPBS Study; Puritano, Improving the Management of the Defense Department, 27 Armed Forces Comptroller 12 (1982).

The general discussion of the PPBS that follows is primarily drawn from these sources. Only a "thumbnail sketch" of the Air Force interaction with the DOD PPBS process is attempted. The DOD/GAO PPBS Study more fully depicts the different services differing PPBS implementations.

19. Puritano, Resource Allocation in the Department of Defense, 29 Armed Forces Comptroller 4 (1984).

20. Id. at 5.

21. DOD/GAO PPBS Study, note 18 supra at 11.

22. For a depiction of these cross-flows, see the figure in DOD/GAO PPBS Study, note 18 supra at 33.

23. Id. at 19.

24. See Ridolfi, PPBS: The Vehicle Through Which Resource Decisions Are Made, Industrial College of the Armed Forces Student Research Report No. 127 (1976).

25. HQ U. S. Air Force/Comptroller, The Air Force Budget 50-54 (1978).

26. Puritano, Resource Allocation in the Department of Defense, note 18 supra at 5.

27. Id.

28. Id.

29. Id at 6.

30. DOD/GAO PPBS Study, note 18 supra at 39 & 81.

31. This discussion is based on Acker, The Acquisition Process: A Brief Historical Perspective, 5 Concepts 74 (1982); Acker & McAleer, The Acquisition Process: New Opportunities for Innovative Management, 5 Concepts 83 (1982).

32. Superseded by a new DOD Directive 5000.1, March 29, 1982, implemented by DOD Instruction 5000.2, "Major System Acquisition Procedures," March 8, 1983, reflecting the present administration's management initiatives undertaken in the DOD Acquisition Improvement Program. See also DOD Steering Group Report, "Improving the Defense Acquisition System and Reducing System Costs," March 30, 1981, including the Deputy Secretary of Defense's memorandum for the Secretaries of the Military Departments and Others, "Improving the Acquisition Process," April 30, 1981 (the "Carlucci



Memorandum"). See generally the special Summer issue of 5 Concepts (1982), for a detailed discussion of the DOD Acquisition Improvement Program. The DOD deflators now used to better budget for inflation are discussed in Borsting, Shaping the Defense Budget: The Role of Economic Analysis, 19 Defense Management J. 31 (1983).

33. Acker, note 31 supra at 78, quoting Acker, The Maturing of the DOD Acquisition Process, 3 Defense Systems Man. Rev. 70 (1980).

34. Quoted in Acker, note 31 supra at 79 n.10.

35. Acker, note 31 supra at 79.

36. Id.

37. Quoted in Acker, note 31 supra at 80.

38. Goldstein, Reducing the Bow Wave in Defense System Budgeting, 4 Concepts 75, 76 (1981).

39. Id.

40. J. Bennett, dissertation submitted to the School of Government and Business Administration of The George

Washington University, "Department of Defense Systems Acquisition Management: Congressional Criticism and Concern," at 69 (1974).

41. This discussion is based largely on Singer & Brabson, Enhanced Multiyear Procurement for Improving Weapon Systems Acquisition, 5 Concepts 112, 113-117 (1982).

42. See Bennett, note 40 supra at 48.

43. Puritano & Korb, Streamlining PPBS To Better Manage National Defense, 25 Armed Forces Comptroller 569, 570 (1981).

44. Id.

45. See note 32 supra.

46. Puritano & Korb, note 43 supra at 572.

47. Id.

48. Id.

49. Bennett, note 40 supra at 68.

50. Kanter, note 16 supra at 39.

51. Kanter, note 16 supra at 39-40.

52. Puritano, note 18 supra at 10.

## **Chapter II. The Congressional Budget Process**

### **A. The Annual Authorization-Appropriation Cycle**

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## Chapter II. The Congressional Budget Process

The Constitution, in Art. I, Section 9, Clause 7 gives Congress the "power of the purse" -- the power to control federal fiscal matters by prohibiting payments from the treasury without a prior appropriation. The Congress is also given the power to specify the conduct of most Executive Branch operations in Art. I, Section 8, Clause 18. The Antideficiency Act, which prohibits both payments and obligations to pay money in excess of or before authorizing appropriations are made available, "unless authorized by law,"<sup>1</sup> appears to to be founded on both authorities. As discussed in Chapter III, the Antideficiency Act provides for either administrative or criminal sanctions for its violation, or both. Many other statutes and implementing agency regulations -- some of which are discussed in Chapter III -- also restrain the executive agencies in their administration of the obligational authority provided by the Congress, with the primary object of restricting the agencies to executing policies established by the Congress.

Congress primarily permits and controls federal spending by 1) making appropriations of funds which are available for specified times, purposes and amounts, or by 2)

authorizing specific contract authority for some agencies to enter into contracts in advance of appropriations to achieve particular purposes. The creation of government corporations, revolving funds, "entitlement" programs and borrowing authority are other means used to fund and control federal activities. Procurement funds are usually made available each year by appropriations, although as noted in Chapter I and discussed in Chapter III, they are usually provided for obligation within a three-year time period.

Despite recurrent -- and recently, enormous -- deficits, the Congress has statutorily stated, and reaffirmed, its "commitment that budget outlays of the United States Government for a fiscal year may not be more than the receipts of the Government for that year."<sup>2</sup>

#### **A. The Annual Authorization-Appropriations Cycle**

In practice, Congress relies heavily on the Executive branch for policy and drafting proposals, as well as for factual data during the annual fiscal cycle, although the Congress has established a non-partisan organization, the Congressional Budget Office (CBO), to provide independent analyses of alternative fiscal, budgetary and programmatic policy choices to support the congressional budget process.<sup>3</sup> Among other functions, the CBO furnishes to the Budget

Committees of both Houses a report on the fiscal policy proposed for the next fiscal year, including alternative levels of revenues, budget authority, outlays, allocations among major programs and functional categories, considering major national needs and estimated effects of such alternative allocations on "major national needs" and on the "balanced growth and development of the United States."<sup>4</sup> The CBO also analyzes the fiscal effects of committee actions and their consistency with the most recent concurrent budget resolution, and produces an independent five-year projection of the total new budget authority and total budget outlays, compared to expected revenues, for each fiscal year in the period.<sup>5</sup>

The Treasury's fiscal year currently begins on October 1 and runs until September 30 of each year.<sup>6</sup> The transition period from the old fiscal year, July 1 to September 30, 1976, was called FY 1976T. Prior to 1977, the fiscal year began on July 1, as it had since 1842. Prior to that year, the government's fiscal year coincided with the calendar year.<sup>7</sup> The fiscal year is called after the calendar year in which it ends -- FY 1986 will begin October 1, 1985, and end on September 30, 1986.

As described in the previous chapter, the annual authorization-appropriation cycle actually begins in the Executive Branch with the preparation and submission of the

President's Budget. This document is the result of a lengthy internal process of debate, weighing and prioritizing alternatives, as the agencies attempt to structure programs which will accomplish the national objectives assigned to each agency by the Congress within the fiscal restraints of the expected congressional budget. The consolidated administration budget request is presented to Congress each January as required by the Budget and Accounting Act of 1921,<sup>8</sup> estimating federal receipts and outlays for the ensuing fiscal year and recommending appropriations in detail.<sup>9</sup> Although the President's Budget includes DOD's consolidated budget request, as approved, the Congress does not have routine access to the documents on which it is based: the Defense Guidance (DG), the current DOD Five Year Defense Plan (FYDP), the services' Program Objective Memoranda (POM's), or most DOD-generated out-year projected data.<sup>10</sup> The Congress conducts lengthy hearings on the proposed budget in the House and Senate Appropriations Committees, and other affected committees during the authorization process, in accordance with the Budget and Accounting Act and the Houses' internal rules.<sup>11</sup>

### **1. The Congressional Budget and Impoundment Control Act**

The Congressional Budget and Impoundment Control Act of 1974<sup>12</sup> -- referred to in this discussion as the Act --



sought to establish a time-table for the congressional budget process. As enacted, the congressional budget process has four main phases: (1) authorizations, (2) budget resolutions, (3) spending measures, and (4) reconciliation. The reconciliation process was intended to discipline the committees' adherence to the budget "targets" established in the first concurrent budget resolution. The congressional budget time-table enacted is:

<u>On or before</u>	<u>Action to be completed</u>
November 10	President submits current services budget
15th day after Congress convenes	President submits his budget
March 15	Committees submit reports to budget committees
April 1	Congressional Budget Office submits report to budget committees
April 15	Budget committees report first concurrent resolution on the budget to their Houses
May 15	Committees report bills and resolutions authorizing new budget authority
	Congress completes actions on <u>first</u> concurrent resolution on the budget
7th day after	Congress completes action

Labor Day	on bills and resolutions providing new budget authority and new spending authority
September 15	Congress completes actions on <u>second</u> required concurrent resolution on the budget
September 25	Congress completes action on reconciliation bill or resolution, or both, implementing second required concurrent resolution
October 1	Fiscal year begins <sup>13</sup>

The reconciliation and second concurrent budget resolution could result in directions to committees to prepare proposals to repeal or amend spending, taxing or national debt ceiling legislation.

May 15 is a critical date in the process because, with the exception of emergency measures, entitlement bills and social security legislation, it is the deadline for committee reporting of authorization measures creating new budget authority. To permit the authorizing committees to meet this deadline, the Act requires Executive Branch submission of proposed authorization legislation before May 16 of the year before the year in which the fiscal year begins (about a year and four months in advance).<sup>14</sup>

The seventh day after Labor Day similarly is a critical date because only three weeks remain before the start of the next fiscal year for both the adoption of the second concurrent budget resolution and -- as originally contemplated -- the reconciliation process.

The Act specifies no date for the adoption of the second concurrent budget resolution. Delays in authorizing and spending bills can cause a failure to enact appropriation bills by the start of the fiscal year. The Act precludes adjournment sine die until the resolution and reconciliation process is completed.

The Act addressed two serious concerns with the congressional budget process. First, in Title X, it sought to control Executive refusals to obligate ("rescissions") or delays in obligating ("deferrals") funds as made available by the Congress to accomplish particular policy objectives; and second, the Act attempted to tighten congressional control over the federal budget, partly by lengthening the time for its consideration of budget requests from six to nine months. While the President's Budget now is the result of a highly centralized, disciplined process, the congressional budget is the result of a collegial, decentralized process. This remains true, despite the Act's establishment of the CBO and the House and Senate Budget Committees, in Titles I and II, an

annual time-table for congressional budget actions, in Titles III and IV, and a new fiscal year, improved program review and evaluation procedures, the use of standard budget terminology and the specification of detailed contents for the President's Budget, in Titles V through IX.

Before the Act, despite periodic efforts at reform, the annual congressional budget was the result of a large number of uncoordinated committee actions that were not integrated with their overall effect on the nation's economy. The new budget committees were intended to provide the missing guidance to the whole Congress concerning aggregate spending, revenue and debt levels. The Act called for two concurrent budget resolutions to first enable the Congress to perceive the budget as a whole before beginning its examination in the congressional committee and subcommittee system, and then to permit forced reconciliation of these committee recommendations to the earlier resolution before a second resolution which would precede enactment of appropriations bills in time for the beginning of the next fiscal year.

The act also sought to control the creation of "uncontrollable" spending, so-called "backdoor" spending (the creation of spending authority outside of the regular appropriations process), and to permit some visibility of and control over actual outlays likely in the budget year.

Backdoor spending was controlled by requiring new contract and borrowing authority -- effective after January, 1976 -- to include a provision limiting effectiveness to the extent funds were actually later provided in appropriations acts. Thus, this source of uncontrollable spending was treated just as other substantive legislation in regards to the government's obligation to later provide funds.

The congressional budget process has been described as an annual factional fight chiefly confined to the budget's margins, because so much of the budget has been determined by prior years' legislation entraining this so-called "uncontrollable" spending.<sup>15</sup> Uncontrollable spending may be seen, therefore, to serve a useful purpose: it tends to confine the annual budget fight and to make it more manageable. "'Uncontrollable' is the cordon sanitaire of budgeting, a way of making budgets by limiting their reach," and thus might be seen as the result of the conscious, collegial decision of the Congress to favor certain nonbudgetary values over budgetary control.<sup>16</sup> To be sure, the Act's reconciliation process, as currently used, widens the arena of budgetary conflict by also drawing into question each year at least some of this "uncontrollable" part of the budget.

## 2. Procedure in the Congress

So, generally, in May in the Congress' budget process, the Budget committees first set an overall ceiling for the defense budget in the first concurrent budget resolution. In mid-Summer, the Armed Services committees produce the Defense Authorization Bill, telling DOD what -- and in what approximate amounts -- it can expect to be authorized to obligate funds for during the budget year. And finally, by September 30, the Appropriations Committees should have reported out and the Congress enacted the Defense Appropriation Act, providing actual budget authority for the next fiscal year. If the appropriations act is not passed before the beginning of the next fiscal year, then Congress must enact a continuing budget resolution before October 1 to prevent at least a partial lapse in appropriations. When the Congress fails to take even the stop-gap funding measure of adopting a continuing budget resolution, there has recently been great confusion among the agencies, and considerable waste has been produced as the federal government begins to close down many of its operations.

The congressional budget begins with a concurrent resolution of the budget. The resolution must include the level of total budget outlays and total new budget authority authorized, an estimate by each major functional category, the

amount of the deficit, the recommended level of receipts, and the level of the authorized public debt.<sup>17</sup> A concurrent resolution on the budget must be passed by both Houses of Congress. Two concurrent resolutions are required before the start of the budget year. The first concurrent resolution on the budget is due by May 15, establishing the congressional budget targets for the next fiscal year for receipts, budget authority, and outlays. The purpose of this first resolution is to provide the Congress a benchmark against which to consider appropriations and revenue matters.<sup>18</sup> Action on the second concurrent resolution is required by the Act to be complete by September 25 -- just a few days before the budget year is to begin as the new fiscal year on October 1 -- and contains budget ceilings classified by function for budget authority and outlays, and a floor for budget receipts. As originally conceived, the second concurrent resolution could change the levels set in the earlier resolution and can direct the committees with jurisdiction over budget authority to recommend changes which would then be resolved in a reconciliation bill or resolution that must meet the September deadline.<sup>19</sup>

### 3. Consideration in the Committee Structure

Congress' dual standing committee structure requires action first by authorizing committees to report out

substantive legislative proposals prescribing the duties and organization of federal agencies or permitting them to undertake particular programs; and only then by appropriating committees which actually provide funds to the agencies thus enabled and authorized. This system was adopted in 1921 to centralize funding responsibility for better control. Before 1921, the appropriations committees were charged with overseeing federal activities in Washington, while both substantive control of and appropriations for federal "field" organizations were within the jurisdiction of the substantive committees. The present diffusion of authorizing and appropriating power prevents any single group from acquiring complete power over the operations of the federal government, and it also permits a "division of labor" allowing the development of specialized expertise in the various committees.<sup>20</sup>

This division of labor and diffusion of power were accomplished through the procedural rules of both chambers.<sup>21</sup> The rules require substantive legislative proposals to be referred to the proper substantive committees and funding proposals to be referred to each House's appropriations committee. Further, the substantive committees were precluded from incorporating appropriations provisions in authorizing bills, while the appropriations committees were precluded from appropriating funds for activities not previously authorized



-- unless intended to reduce expenditures. This exception, known as the Holman rule, has been used to justify the many substantive General Provisions attached to appropriations acts.<sup>22</sup> However,

Since the rule [requiring prior action by the authorizing committees] is procedural in nature, an otherwise unauthorized legislative item in a duly enacted appropriation will be fully as effective as any other legislation if points of order under the rule are waived in advance of the consideration of the bill, or if no point of order is raised during debate by any member, or if a point of order is raised and sustained by the Chair but voted down.<sup>23</sup>

One commentator sees the legislative "division of labor" between authorizing and appropriating committees to have been used to meet two conflicting pressures: to finance government programs, and to guard the Treasury against over-expenditures. The authorizing committees, having "substantive jurisdiction," functioned as program advocates; the appropriating committees to some degree guarded against excess spending. This role distinction has been weakened by the reconciliation process, since it permits the budget committees to direct substantive program changes designed to achieve budget reductions.

The appropriating committees' traditional roles also have been changed by the reconciliation process, because reconciliation instructions tend to narrow the options of the appropriating committees -- and furthermore, by aiming

reconciliation instructions at authorizations, which tend to have multi-year consequences, spending cuts reaching beyond just the upcoming budget year can be effected. Thus, the reconciliation process tends to erode the basis for the dual authorization-appropriation committee structure and, in fact, increasingly more legislative provisions have been grafted onto appropriations measures while more "financial detail" has been placed in authorizations. It has been suggested that the time may have come for the dual committee structure to be melded into program committees.<sup>24</sup>

In both Houses, after May 15 following completion of the substantive committees' authorization bills and the first concurrent budget resolution, action passes to the appropriations committees, under the Act's scheme. The first concurrent budget resolution's total budget authority and outlays are distributed among the committees having jurisdiction over the subject matter areas comprising the various functional categories. The committees then further subdivide the budget authority allocations to their subcommittees. The appropriations bills originate in the House by custom, although this practice is not required by the Constitution which provides in Article I, Section 7, Clause 1 that "[a]ll bills for raising revenue shall originate in the House of Representatives; but the Senate may propose or concur with amendments, as on other bills."

To illustrate, consider the process as applied to the DOD budget request, as incorporated in the President's Budget. The President's Budget is referred to the House Committee on Appropriations (HAC), and the DOD portion is further referred to its Department of Defense Subcommittee (HASC). Extensive hearings are held. The subcommittee drafts an appropriation bill for consideration by the full committee and then to the full House concerned, accompanied by their reports. The subcommittee bill could be amended either by the full committee or on the House floor.

Meanwhile, the Senate Committee on Appropriations (SAC) Department of Defense Subcommittee (SASC) -- as the result of a similar process -- conducts similar hearings, relying to some degree on the records of proceedings in the House. Often agency appeals for more funds than provided in the House bill are focused on the Senate committees. The Senate's version of the appropriation bill is referred back to the House. Disagreements are referred to and resolved by a Conference Committee composed of members of both chambers' appropriations committees, which produces a conference report. Approval of the conference committee's report by both Houses of Congress results in the final appropriations bill, which is enrolled and sent to the President for his veto, or adoption by his signature or inaction.

By House and Senate rules,<sup>25</sup> provisions in appropriations acts must have been preceded by express authorization acts which must originate in the committee having jurisdiction over the subject matter involved. In the case of the Department of Defense, this means the House Armed Services Committee (HASC). Under the Act, it is not in order for either house to consider new spending legislation that would exceed the levels specified in the second concurrent budget resolution, or to reduce revenues below the levels on which the congressional budget has been predicated.

Meanwhile, on or before July 15,<sup>26</sup> the President transmits a supplemental summary of the budget -- also called a mid-year or mid-session review -- addressing the budget year being deliberated by the Congress. The summary covers

- (a) all substantial alterations in or reappraisals of the estimates of expenditures and receipts,
- (b) all substantial obligations imposed on that budget after its transmission to Congress,
- (c) the actual or proposed appropriations made during the fiscal year in progress, and
- (d) the estimated condition of the Treasury at the end of the fiscal year if the financial proposals contained in the budget are adopted. The summary also contains any information the President considers necessary or advisable to provide the Congress and a complete and current estimate of the functions, obligations, requirements, and financial condition of the Government for that ensuing fiscal year.<sup>27</sup>

Also, during the course of all its fact-finding and deliberations on the budget year and the myriad other pressing legislative concerns of the Congress, it must deal with supplemental and deficiency appropriations requests for the current fiscal year,<sup>28</sup> as well as proposed Executive agency reprogrammings of funds to meet unforeseen exigencies. This monumental, unrelenting bulk of work has led to a shortening in practice of the two-stage process contemplated by the Act. Alice Rivlin, the first director of the Congressional Budget Office, summarized the recent evolution of the process:

[O]riginally the budget process on the Hill was conceived as a two-stage iterative process in which you had a serious debate in the spring on the first concurrent resolution of the budget, then the Congress would work on all the individual spending and taxing bills, and then it would have another serious debate in September in which it put together the individual actions with the original budget targets, reconciled the parts with the whole, and passed a second and final resolution on the budget before the beginning of the fiscal year in October. It's turned out that it's just too complicated to do all that -- that there isn't time for that two-stage process -- and it's become clear that if you're going to make decisions on the budget that have any meaning, you have to make them early in the year. So the first resolution has become the focus of attention, and the second resolution has really gone by the board. If the decisions are made in May, the second resolution is not necessary. And the reconciliation process, the process of bringing the pieces into conformance with the totals, has been moved by common consent from the second resolution to the first one. I think that just an example of the adaptation of the process to the necessity of making decisions more quickly.

A more drastic suggestion has been made to move to a biennial budget in which we would essentially make all these decisions for two years and then have the intervening year to worry about something else. I think that's sensible -- not just because it would relieve the pressure on congressional decision-making, but because it would give states and localities [and federal agencies] more definiteness about what they will get from the federal government over a longer period and would facilitate planning at the state and local level.

. . . People have remarked that Congress doesn't do anything except work on the budget these days, and that's virtually the truth. . . .

. . . The Congress has in fact not enacted very much legislation in the last two or three years. There has been a marked drop-off, with very few new programs enacted at all. . . .<sup>29</sup>

#### 4. Reconciliation Instructions

The reconciliation process offers an integrated and expedited debate over proposed budget reductions, permitting the budget committees to enforce the concurrent resolution's spending and revenue targets by directing substantive committees to report changes in legislation designed to achieve those targets. The reconciliation process was not actually used until FY 1981 because the budget committees were unwilling to risk being defeated and because the time-table originally allowed only 10 days for preparation of reconciliation instructions after adoption of the second budget resolution. However, since FY 1981, reconciliation instructions have been placed in the first budget resolution, which both reduces the importance of the second resolution,

and makes the first resolution's targets virtually "binding limits," rather than mere targets.<sup>30</sup> This change has also changed the nature of the reconciliation process itself, broadening its scope and permitting it to be applied to legislation in a way not contemplated when the Act's procedures were adopted: reconciliation is now applied not just to legislative decisions made between the first and second concurrent budget resolutions, but also to legislation enacted in previous years, particularly the social entitlement programs, thus speeding the accommodation of the budget to current political attitudes.<sup>31</sup> The reconciliation process tends to redistribute political power between the authorizing and appropriating committees,<sup>32</sup> and between the House and the Senate, since the Senate no longer withholds all action on budget matters until the House has acted.<sup>33</sup>

#### **5. Gap-Fillers: Budget Authority Provided in Continuing Resolutions**

In theory, all appropriations bills must be passed by the 7th day after Labor Day, as specified in 2 U.S.C. § 631, but in practice this goal has seldom been attained. The authority gap created by the lapse between the budget authority created by the old appropriation act and the enactment of an appropriation act for the new fiscal year is usually filled with the limited authority created by

continuing budget resolutions, which generally authorize continued expenditures consistent with some stated standard. Of course, no-year and multiple-year appropriations still unobligated or unexpended are not affected by continuing budget resolutions -- but the impact on procurement programs dependent on annual appropriations may be marked.

Continuing resolutions have the "same force and effect as an Appropriations Act."<sup>34</sup> Further, even though authorization for a program has expired, specific inclusion of a program in a continuing resolution will provide sufficient authority to continue it.<sup>35</sup> Conversely, funds validly obligated under a continuing resolution remain available to liquidate those obligations, even though a later appropriation act does not provide for those programs, and the Treasury must restore the affected accounts to the extent necessary to pay those obligations.<sup>36</sup>

Normally, however, continuing resolutions provide that obligations under the resolution may not exceed a stated standard, and that while old programs may be maintained, new programs may not be started.<sup>37</sup> Usually, a maximum obligation rate is specified at which obligations may be incurred based on the rate of the prior year (the "current rate"), the President's budget request (and the agency is bound by its budget estimate therein), or the lesser of the appropriations



bills passed by either House of Congress.<sup>38</sup> The "current rate" refers to the total funds which were made available for particular times and purposes for the accomplishment of particular programs during the past fiscal year.<sup>39</sup> Funds provided by continuing budget resolutions are not subject to the administrative apportionment system usually applied to appropriated funds. Control is provided by the issue of temporary Treasury appropriation warrants which are requested by affected agencies in amounts estimated as sufficient to continue operations at the previous level. Warrant funds are allocated by agencies to subordinate levels in the usual way, however, and they are subject to the same internal control policies as appropriated funds.<sup>40</sup>

Congress has often been compelled to resort to continuing budget resolutions to avoid threatened cessation of most government functions. Continuing budget resolutions are enacted when legislative action on appropriations is not completed by the beginning of the fiscal year to provide budget authority for government to continue in operation between the end of the current fiscal year and the enactment of the next regular appropriations bill. In the last six years, DOD has had only one appropriations bill enacted by October 1, and in the last 15 years, only 3. In 19 of the last 21 years, DOD began the fiscal year with a continuing resolution -- and this includes the most recent six years

since the Congress changed the fiscal year precisely to achieve more time for its authorization-appropriation process.<sup>41</sup> In the years between 1961 and 1981, at least 85 per cent of the appropriations bills for all government agencies were late, requiring over 74 continuing resolutions and, recently, even the continuing resolutions have often been late, creating actual appropriations lapses for some agencies.<sup>42</sup> In the four fiscal years from 1977 to 1981, there were actual appropriations lapses for some agencies each year.<sup>43</sup> For DOD, including the separate Military Construction appropriation bill, there were funding gaps totalling 214 days, as of FY 1981.<sup>44</sup> And on eight occasions since 1962, appropriations acts were never completed at all, and affected agencies operated throughout the entire fiscal year on the authority of continuing resolutions. Five of those failures occurred since the enactment of the congressional budget action time-table.<sup>45</sup> Thus, for DOD as for other federal agencies, continuing budget resolutions have become the usual result of the annual congressional budget cycle, rather than the exception.

Continuing budget resolution authorities are not perfect solutions to the problems created by lateness of congressional budget actions, however, partly because they create accounting problems since their termination dates are not established to coincide with any standard accounting

period, but rather often are established at short intervals designed to put political pressure on the administration. More importantly, continuing budget resolutions necessarily delay the beginning of the fiscal year's budget, squeezing the administrative actions of its actual execution into whatever time remains for the fiscal year after the budget is finally definitively provided in an appropriations act.

Also, continuing resolution authorities do not represent any considered congressional judgment of what might constitute a well-defined and balanced spending scheme -- and thus provide no sound basis for agency or contractor planning. These authorities generally provide no allowance for such perhaps desirable greater expenses as new program starts, nor any accommodation to payroll increases, cost of living changes, or R&D contract increases due to unexpected obstacles. When operating under continuing budget resolution authority, agencies are often reluctant to allocate sufficient funds to cover an entire year for existing programs, fearing budget cuts. This can create especially difficult problems of choice with multi-year procurements, when the contracted program year ends shortly after the fiscal year.<sup>46</sup> And finally, but not least, all this uncertainty slows submission of agency reprogramming proposals to shift funds to meet unexpected contingencies.

## 6. Appropriations Lapses

In fact, the Congress' time-table for budget actions has seldom been met, and actual lapses in the executive agencies' budget authority have occurred frequently -- despite the availability of the legislative device of continuing budget resolution authority as a "gap-filling" measure. Lapses have caused confusion and waste as agencies struggled to comply with the fiscal control laws created by the Congress to preserve its "power of the purse," even though these laws do not adequately provide for the Congress' perennial lateness in accomplishing its role in the process of providing funds for the government to operate.

Prior to 1980, the impact of actual appropriations lapses was less marked, because the Comptroller General and OMB had taken the position that the Congress did not intend federal agencies to be closed during periods of lapsed appropriations and, accordingly, they did not close. In 1980, however, the Attorney General issued an opinion stating that "during periods of 'lapsed appropriations,' no funds may be expended except as necessary to bring about the orderly termination of an agency's functions," and that the obligation or expenditure of funds for any purpose not otherwise authorized by law would be a violation of the Antideficiency Act.<sup>47</sup> Further, he stated that if a lapse occurs, "agencies

may incur no obligations that cannot lawfully be funded from prior appropriations unless such obligations are otherwise authorized by law. There are no exceptions to this rule under current law, even where obligations incurred earlier would avoid greater costs to the agencies should appropriations later be enacted,"<sup>48</sup> The Attorney General was willing to imply authority to incur obligations necessary to an orderly shutdown of operations,<sup>49</sup> but he promised prosecution of willful violations of the Antideficiency Act.

OMB issued a bulletin and two memoranda to agency heads, instructing them how and to what degree to go about shutting down operations, should the Congress fail to provide funds by October 1.<sup>50</sup> Basically, they required agency advance planning to implement a general, phased shutdown of operations, excluding activities "otherwise authorized by law" (which included the shutdown activities themselves, and those that protect life and property.

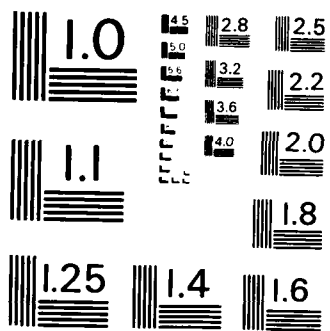
Fiscal Year 1981 opened without all 13 appropriations bills passed, and the Congress did not pass a continuing resolution until a few hours after the beginning of the fiscal year. This brief funding hiatus resulted in a direct waste of more than \$2 million, according to the GAO.<sup>51</sup>

Several months after the appropriations hiatus flap, both the Attorney General and the Comptroller General analyzed the problem in greater depth.<sup>52</sup> The Attorney General's second opinion was in response to the President's request for a "close and more precise analysis" of the effects of this more rigorous adherence to the Antideficiency Act. The Attorney General found that ordinarily, excluding circumstances in which the President may have some inherent obligational authority springing directly from his Constitutional powers,

should an agency's regular one-year appropriation lapse, the 'authorized by law' exception to the Antideficiency Act would permit the agency to continue the obligation of funds to the extent that such obligations are: (1) funded by moneys, the obligational authority for which is not limited to one year, e.g., multi-year appropriations; (2) authorized by statutes that expressly permit obligations in advance of appropriations; or (3) authorized by necessary implication from the specific terms of duties that have been imposed on, or of authorities that have been invested in, the agency.<sup>53</sup>

The Attorney General concluded, after a lengthy analysis of the inherent obligational authority of the President and the application of the "otherwise authorized by law" exception to the Antideficiency Act<sup>54</sup> that leeway existed to permit the Executive Branch to perform essential functions and to make the government workable, although "[a]s the law is now written, the nation must rely initially for the efficient operation of government on the timely and responsible functioning of the legislative process."<sup>55</sup>





MICROCOPY RESOLUTION TEST CHART  
NATIONAL BUREAU OF STANDARDS - 1963 - A



The Comptroller General drew a grim picture of the consequences of an extended funding hiatus, amounting to a general breakdown of all but the most vital federal government operations within a month.<sup>56</sup>

The Comptroller has found that the primary cause of both late appropriations and funding gaps has been riders concerning politically-sensitive issues attached by congressional factions to achieve political leverage.<sup>57</sup> The use of riders on appropriations bills and continuing resolutions has increased dramatically since the mid-sixties. Politically-sensitive riders have included emotional issues often having no substantive relation to the bills to which they were attached, recently including such issues as busing, abortion and congressional pay increases. Other riders are more mundane, designed to serve particular interests. Consider how FY 1981 appropriations were placed in jeopardy by these legislative tactics:

Because agreements in the Senate could not be reached about budget ceilings, by October 1, 1980, Congress had completed action on only 3 of its 13 major annual appropriations bills. Passage of a continuing resolution to provide stopgap funds bogged down because of debate on an abortion rider, but in order not to risk enforcement of the Antideficiency Act, Congress did pass, in the afternoon of October 1, a continuing resolution authorizing funds until December 15, 1980.

During the ensuing 2-1/2 months, debates on non-fiscal type riders continued as Congress deliberated the passage of a second continuing resolution to make sure that agencies could continue operations after midnight on December 15. At stake were operating funds for several large Departments: Commerce, Justice, State, Labor, Health and Human Services and Treasury as well as the funds for foreign assistance, the postal service, and the legislative and judicial branches.

Dozens of riders -- especially on the issues of busing, the congressional pay raise, and the 9-digit zip code -- prolonged debate on the second resolution. During the last few days of deliberations, the Senate added 148 riders to the spending package before it went to final conference with the House. These measures included such items as \$2.7 million for the Lake Placid Olympic Committee, \$150,000 to fight the asparagus aphid, and \$100,000 for pea research. Debate on the bill extended past the deadline into the early morning hours of December 16 before members agreed that the riders were jeopardizing all chances of enactment. As finally passed, the second continuing resolution was stripped of most of the riders and provided the funds needed to keep the Government operating through June 5, 1981, when Congress will be confronted with the problem again.

The political entanglements of recent years are likely to happen again and again if controversial and essentially substantive legislative issues continue to be debated during the appropriations process. Even the recent strict interpretation of the Antideficiency Act, though dramatizing the phenomenon of funding gaps, neither eliminates them nor improves the timeliness of appropriations bills.<sup>58</sup>

In his report the Comptroller analyzed six alternative solutions to this problem, and ended by recommending that the Congress enact permanent legislation allowing federal agencies to incur obligations, but not expend funds, when funding gaps occur. Presumably, some standard like that used with continuing budget resolutions could be developed to limit

agency obligations during such periods -- but neither employees nor contractors could be paid during a funding hiatus if their right to payment sprang from an obligation incurred under such authority. Such an act could provide express authority clearly stating the scope of the Antideficiency Act's "unless otherwise authorized by law" exception. The Comptroller also suggested that the Congress study biennial budgeting, and the establishment of a reserve for Fall and Spring budget adjustments for emergencies and uncontrollable cost growth.

This proposal would, however, do nothing to solve the basic problem. Under current congressional budget process practice, the continuity of many important federal agency operations may be held hostage by congressional factions too weak to enact substantive legislation establishing their views as national policy. Therein lies both the greatest weakness and the greatest attraction of the current practice. Clearly, such leverage permits the airing of less popular views and is politically useful -- but the direct and indirect cost of such political advantage may be so high that the Congress should act to provide some other means of expressing such views and to protect its budget process from such often unrelated substantive legislative attempts. Unless this first is done, to adopt biennial budgeting would only double the leverage of such advocates, and greatly magnify the effects of continuing

budget resolutions and funding gaps.

**B. Problems Created In the Agencies  
By the Congressional Budget Process**

The congressional budget process creates many problems of budget formulation and execution in the agencies. One commentator sees these problems as springing from several causes:

-- the major expansion of both the staffs and the committee structure in terms of hearings and oversight of DoD, and the resulting expansion of paper, time, and human resources committed in DoD to respond to ever-increasing Congressional demands;

-- the uncoordinated and overlapping distribution of defense review and oversight responsibility among the many budget, authorizing, appropriation, intelligence, and oversight committees and subcommittees;

-- the short-range (one year), line item by line item focus of the Congressional review, rather than a focus on longer-range and mission-wide analyses;

-- the distortions of defense programs that result from political pressure on the Congress (and on the Defense Department) by the defense industry;

-- the need for Congress to better evaluate the DoD budget in relation to foreign policy and military objectives and goals -- in the macro sense, rather than focusing on line item changes.<sup>59</sup>

Various congressional committees and subcommittees share sometimes overlapping legislative jurisdiction over different parts of the federal agencies's programs. For

example, DOD's programs are reviewed by and defended before at least the House and Senate Armed Services Committees and Subcommittees, the Senate and House Defense Subcommittees, the Senate and House Military Construction Subcommittees, and the Intelligence Committees. The Senate Armed Services Subcommittee is further subdivided into the following areas of specialized expertise: Military Construction, Tactical Warfare, Strategic and Theater Nuclear Forces, Preparedness, Sea Power and Force Projection, and Manpower and Personnel. The House Armed Services Committee is subdivided thus: Research and Development, Procurement and Military Nuclear Systems, Military Personnel and Compensation, Readiness, Investigations, Military Installations and Facilities. Often, especially in the smaller Senate, the membership of these committees overlaps -- and further, some of the same legislators are also seated on their chamber's Appropriations and Budget committees.<sup>60</sup>

Especially, the congressional failure to enact DOD's appropriations acts on time severely disrupts the agency's functioning:

The lack of well-defined and fixed spending plans results in . . . a suspension of many activities in the areas of procuring weapons systems (often day for day delays), maintenance contracts, and repair contracts. Large annual contracts may be deobligated and renegotiated monthly, resulting in higher costs and severe disruption to those programs involved. Delays in contract award for combat

readiness and other initiatives and delay or cancellation of combat training exercises are common. These can result in higher costs, decreased combat readiness, and increases in maintenance backlogs that may not be fully absorbed later in the fiscal year.<sup>61</sup>

One commentator has remarked that the Congress seems to have taken, in recent years, such a detailed interest in DOD's program development and review functions that it has hampered the ability of the agency to function as well as the ability of the Congress to take timely appropriating action on the very programs it is overseeing. The Congress has developed an intense focus on "programmatic and budgetary detail" as opposed to "policy-level, strategic or mission-oriented, goal-related analysis and review."<sup>62</sup> He notes that

In 1983, 1306 DoD witnesses provided 2610 hours of testimony in hundreds of appearances before a total of 96 different committees and subcommittees. In addition, there were approximately 85,000 written inquiries and nearly 600,000 telephone calls during the year from the Congress. In 1983, DoD provided Congress with 21,753 pages of justification documents in support of the FY 1984 budget request, a threefold increase over 1970.

This growth in testimony and in the provision of documents has not necessarily served to produce better results. The vast number of committees and subcommittees have led to overlapping jurisdictional problems and to the addition of legislative directions and restrictions for DoD.

For example, the enactment of authorization provisions or limitations into appropriation bills, in direct violation of Congressional rules, has grown considerably. In FY 1984, there were 107 such

general provisions in the DoD Appropriations Act. There were an additional 68 general provisions in the DoD Authorization Act, and another 41 general provisions appeared in the authorization and appropriation acts that cover military construction, for a total of 216 general provisions directed to DoD. This compare with only 101 such provisions in FY 1978, an increase of over 100 percent in only six years. In addition, in FY 1984 legislation Congress also directed 661 specific actions (compared to 382 in FY 1978) and called for 422 reports (compared to 153 in FY 1978) for the Department of Defense.<sup>63</sup>

Of course, there are institutional, political reasons for this proliferation in congressional committees and the increasingly detailed exercise of the congressional oversight function that go beyond what has been described as the maintenance the proper balance of trust and suspicion between the two branches of government.

One reason why the Congress should restrain its recent tendency to become deeply involved with agency programmatic decisions may be that the Congress, as a political, collegial body, might be incapable of making such choices in ways based on the the most effective allocation of resources.

Two students of the Congress have suggested that four types of role behavior might be seen to characterize congressional decision-making, at least during the course of weapons procurement oversight. These are constituency-serving, agency-serving, institution-serving, and career-serving behavior:<sup>64</sup>

[W]e find that the procurement requests which Congressmen are called upon to authorize and fund sometimes pit the interests of one district against another, one service against another, one or all of the services against the Secretary of Defense, the Secretary of Defense against the Office of Management and Budget, or Congress against the Executive. Further conflicts sometimes arise from the interests attached to the personal political goals of a congressman -- for example, the goal of re-election or of ascent to higher political office. In sum, the congressmen we studied were faced with conflicts among the interests of the constituencies they represent, the agencies they oversee, the branch of government they serve, and the career pattern to which they aspire.<sup>65</sup>

The word "sometimes" is emphasized because these commentators found congressmen rarely presented with choices between alternatives, but rather with the task of approving or disapproving the surviving alternative presented in the President's Budget. This occurs because the agency budget processes have already eliminated alternative solutions as unsatisfactory and because proposals submitted to the Congress have been carefully structured whenever possible to eliminate role conflicts which would require congressmen to exercise such choices.

Sometimes, however, these role conflicts cannot be avoided. Then, congressmen must make choices among alternative solutions, and their choices -- which collectively evolve into the policy position of the government -- may not be based on the objective, real-world utility of the weapons



systems at stake:

Contrary to the notion that decisions are made in the currency of either "strategic" or "structural" policy, we found in our case studies that procurement decisions were made in terms of a medium of exchange largely internal to the committees. Both strategic and structural, and foreign and domestic considerations appear to have been converted into this currency as the process of making choices took place. The choices which congressmen made concerning military procurement turned neither on the single question of the strategic merit of the alternatives in question, nor on the single question of whether resources would be allocated to particular congressional districts. Instead, procurement choices resulted from a process in which the various alternatives were evaluated not only in terms of strategic or structural features, but also in terms of a whole network of interpersonal, intercommittee, and interchamber considerations. Our studies illustrate, as one author has phrased it, that

The lesson to be drawn from any study of high politics is that the central concern of practitioners is with their position relative to one another.

When choices had to be made, the alternative most consistent with maintaining or enhancing the choice-maker's present or future position in Congress tended to prevail. Seen in this light, the processes we have observed seem typical of controversial policy-making in Congress regardless of the issue in question. Painless decision-making in which all constraints push congressmen in the same direction is probably the rule rather than the exception. Yet when the choices are hard ones, congressional decision-making, whatever the issue area, seems dominated by concern for maintaining or advancing the decision-maker's political position within the Congress or some other salient political area.<sup>66</sup>

This is not to say that the congressional committee structure is incapable of developing the technical expertise

necessary to understand the bases for agency choices, only that in a collegial body such as the Congress perhaps too few of its members may be sufficiently knowledgeable on such technical issues to prevail when such wide-ranging, non-issue-related interests are perceived as at stake. In fact, the development of such depth expertise may serve individual congressmen's career goals,<sup>67</sup> and the typically short tenure of agency program managers may actually create occasional situations in which certain members of particular committees have a better grasp of some technical issues than the agency program managers then serving.<sup>68</sup>

Nevertheless, this observation published in 1964 appears to remain valid, despite the intervening congressional budget process reforms:

The process we have developed for dealing with interpersonal comparisons in government is not economic but political. Conflicts are resolved (under agreed-upon rules) by translating different preferences through the political system into units called votes or into types of authority like a veto power. There need not be (and there is not) full agreement on goals or the preferential weights to be accorded to different goals. Congressmen directly threaten, compromise, and trade favors in regard to policies in which values are implicitly weighted, and then agree to register the results according to the rules for tallying votes.

. . . .

In the American context, a typical result is that bargaining takes place among many dispersed centers of influence and that favors are swapped as in the case of log-rolling public-works

appropriations. Since there is no one group of men who can necessarily impose their preference upon others within the American political system, special coalitions are formed to support or oppose specific policies. Support is sought in this system of fragmented power at numerous centers of influence -- Congressional committees, the Congressional leadership, the President, the Budget Bureau, interdepartmental committees, departments, bureaus, private groups, and so on. Nowhere does a single authority have power to determine what is going to be in the budget.<sup>69</sup>

This diverse political environment sometimes produces results conflicting with the needs of national defense as perceived by the Executive Branch:

The Congress may, and does [sometimes] require DOD to spend money on weapons systems and operations (e.g., bases) that DoD has not requested. . . . From the services' viewpoint, it is better to anticipate and accommodate congressional desires in building . . . programs than have the Congress adjust those programs later to reflect congressional priorities and concerns.<sup>70</sup>

### **1. Program Instability and Waste**

The Congress' recently very detailed exercise of its oversight function through the authorization-appropriation process produces much program instability and waste.

Much of DOD's outdget is authorized and appropriated annually, unlike many other areas of the federal budget which are characterized by their so-called "uncontrollable" nature. Because such a large proportion of the federal budget is

"pre-dedicated" to various statutory entitlement programs -- programs that have mushroomed in recent years -- increasingly, DOD's large, and largely annually-funded budget has been seen as the least troublesome source of budget cuts. This susceptibility to congressional budget trimming produces procurement program instability, with the waste inevitably attendant to program terminations, cancellations, or stretchouts.

The dimensions of the program instability problem on realistic long-range planning by the agencies or their contractors that result from the agencies' attempts to accommodate the many conflicting needs stated in their budget submissions to the uncertain results of the congressional budget review process is illustrated by a recent study of the Navy's shipbuilding program:

One of the fundamental issues underlying the total planning effort is the question of what resources will be made available to obtain the ships that the Navy believes it should acquire. Traditionally, the financial resources which are ultimately made available to the Navy seldom support the ship acquisition program it believes is necessary to ensure the security of the nation. This circumstance encourages vigorous debate within the Navy and among others associated with the program decisions. This debate and the inevitable mismatch between perceived needs and available resources often force complex trade-offs among ship types, delivery dates, and program priorities. As a result, the final Navy program represents a compromise among competing program sponsors and is usually a disappointment for many of the participants involved in its development.

Debate and compromise continue as the Navy program moves through successive congressional reviews. Since the Congress serves as the "court of last resort," a number of these positions and the arguments in their support are placed before the Congress -- usually in response to a specific question or, on occasion, as a result of congressional invitations to various constituencies to appear and state their views. These views, which are often offered with strong congressional backing, may result in additional changes to the President's program. For example, the fiscal year 1978 budget which was submitted by President Ford requested two SSNs, whereas President Carter's submittal requested one. The House Armed Services Committee approved two of these ships; however, the Senate Armed Services Committee approved only one, and the latter position prevailed. Similarly, President Ford requested 11 FFGs, while President Carter requested nine; the Congress approved eight. Both President Ford and President Carter requested four fleet oilers, and the Congress approved two.

Another change to the fiscal year 1978 budget submittal occurred with respect to the DD-963 class. Neither President Ford nor President Carter requested funds for these ships. However, the Senate Armed Services Committee decided to include one ship of this class in the budget, and the Committee's position was approved by a House and Senate Conference. . . .

The Air Force experience has been similar:

One reason we need multiyear contracts is that, since the 1960's, not a single major Air Force program has been procured according to its original schedule. In every instance, actions by either the Pentagon or the Congress have resulted in stretchouts. To better appreciate the cost of stretchouts, consider the following data pertinent to the F-15 and F-16:

-- The original schedule for buying 729 F-15s called for production of the last aircraft in 1980. The President's 1981 and 1982 budgets called for stretching the program to 1984, an extension that added \$1.68 billion to the cost of the 729

aircraft yet to be built.

-- Under the original schedule for buying the 1,388 F-16s, the last aircraft was to be produced in 1987. The President's 1981 budget stretched that completion date to 1989; the 1982 budget stretched the program even further, to 1991. These delays added \$2.5 billion to total program costs for the same number of aircraft.

The multiyear approach can help avoid such costs. . . . Applying [its] principles to selected acquisitions could routinely save from 10 to 30 percent of the contract price.<sup>72</sup>

This is a longstanding problem. In 1970, one researcher found that the greatest source of Air Force change-generated cost growth was attributable to program changes, in the end greatly affecting unit costs.<sup>73</sup> The most common cause for cost growth in major systems acquisition programs is financial instability. In 1980, 47 major programs reportedly experienced a cost growth of 129 per cent, 27 per cent of which was attributable to inflation, and 41 per cent attributable to quantity and schedule changes similar to those described above.<sup>74</sup>

Another source of program instability has been the Congress' consistent failure to enact DOD's appropriation acts in accordance with the schedule it established in the Budget and Impoundment Control Act of 1974.

## 2. Improvement Possibilities

The House and Senate budget committees conduct continuing studies on proposals to improve the budget process,<sup>75</sup> but as a collegial organization, the Congress changes only slowly and through consensus, unlike hierarchical organizations.

Congress could prevent the ill effects of appropriations lapses and of continuing resolutions' limited and uncertain authority by rigorously adhering to the schedule of the Budget and Impoundment Control Act of 1974.

Alternatively, it could give DOD authority in its continuing resolutions to obligate funds for new starts and new multi-year procurements.

A biennial budget might also solve some of the uncertainties and instabilities caused by late appropriations acts. There have been several biennial budget proposals in recent years.<sup>76</sup> The Congress could allow itself one year for the authorization process during which it would review DOD major policies and programs; and in the second year, it could conduct more detailed oversight hearings in its appropriations process. Alternatively, the Congress might provide for two years' funding needs in a single year's budget process. An

obstacle to biennial budgeting is that an outgoing Congress would, in its second session, commit the next Congress, which would disable newly-elected representatives from making changes they might have been elected to attempt to make. Another objection is that a biennial budget would engender a larger number of supplemental appropriations requests, only resulting in clogging the system further since they follow the same route through the Congress as regular budget requests. Also, the budget is the primary instrument of national fiscal policy, and a two-year cycle would make it much less capable of reacting to changes in economic conditions. And finally, the annual budget process imposes a time discipline on both the agencies and the Congress which tends to encourage making decisions -- although often late, in recent practice -- that might be later still in a two-year cycle, with proportionately more drastic consequences attached to their lateness.

Short of full biennial budgeting, multiyear authorization might be considered, and the time pressures could be significantly reduced by "rolling" multiyear authorizations -- permitting consideration of the year following the budget year for advance authorization, and thereby precluding the need to defend programs for the budget year during every budget cycle.<sup>77</sup>



Another possibility -- at least as to major systems -- might be some form of "incremental decision-making" in which congressional reviews would coincide with major life cycle decision points, which have no necessary relationship to the fiscal year budget cycle.<sup>78</sup>

But there is no shortage of other suggestions:

There have been many suggestions for Congressional improvements. Some, if implemented, could be of great value in improving the defense resource allocation process. A simple listing of the most important of these from my point of view [is]:

- have appropriations bills completed by the beginning of the fiscal year;
- consider rationalizing responsibilities and jurisdictions among the budget, authorizing, and appropriations committees in both the House and Senate;
- consider utilizing joint hearings, either within the House and Senate or even between the two houses, particularly on the same subjects (e.g., military construction, retired pay, personnel compensation, etc.);
- consider reducing the number of defense subcommittees and/or the number of hearings;
- consider the scheduling of more detailed briefings rather than hearings;
- consider biennial budgeting or an extension of the multiyear funding concept, particularly in areas where there is agreement between the executive and legislative branches;
- consider making all three years of the Congressional budget resolutions binding on the Congress. (In FY 1984, DoD presented a budget request to Congress that met the FY 1984 target

figure set in the FY 1983 concurrent budget resolution. Congress subsequently reduced that figure, in the end, by \$18 billion);

-- consider a Presidential line item veto, so that marginal programs can be excised by the President without the need to veto or jeopardize the entire bill.<sup>79</sup>

Appropriating by broad resource categories has the advantages of administrative flexibility, and the disadvantage of lessened congressional control can be limited by adjusting the reprogramming thresholds to suit current conditions. Still, there are those who have long advocated changing the congressional appropriation structure to more closely align it with the agencies' output-related budget categories. For example:

Appropriations should, in general, be made for major programs and perhaps some of their major subdivisions, and within programs separate appropriations would probably be desirable for research and development, construction, major procurement, and for current operations. Those for current operations could be made for obligation within the financial year. For long-lead items, however, longer-term funding would be necessary in order to facilitate effective programming. However, in fluid situations, where the program structure is and should be subject to change, a more stable appropriation structure may be desirable. The Department of Defense retains its old appropriations side by side with its new program system. Whether this should be a transitional or a permanent arrangement remains to be seen.<sup>80</sup>

Of course, the arrangement has proven to be enduring, partly because there are other, less than obvious considerations involved in proposals to modify the structure

of the input-related congressional appropriations accounts to more closely align them with the output-related PPBS budget formulation and execution categories used by the agencies. For example, it has been suggested that such a change, while it might permit the Congress to focus more explicitly on output capability issues as it allocates the nation's public resources, it might also raise such fundamental issues as the advisability of disturbing the current power balance between the Legislative and Executive Branches and forcing sweeping changes in the federal agencies' internal organizations.<sup>81</sup>

Such a change would greatly simplify the agencies' budget tasks, relieving them of the burdens of translating their out-related categories into the congressional input-related categories and of maintaining their present dual program element and appropriation accounting systems. Further, changing the congressional categories to output-related program categories would permit the Congress to explicitly evaluate alternative program proposals in terms of high-level policy, strategic considerations and their associated risks.

However, it has been observed that the current structure does not necessarily preclude the Congress from addressing output capability issues during their annual budget review process. The 1983 Joint DOD/GAO Working Group on the

PPBS noted that the Congress does, in fact, review and consider output-oriented issues by "moving outside of the appropriations structure for its policy review rather than by using an appropriations structure keyed to outputs,"<sup>82</sup> even though the authorization and appropriations bills are stated along the input-related lines of the Congress' appropriations accounts.

One often-stated advantage of appropriating, and accounting for, the federal budget in broad input or resource categories is that it permits a greater degree of flexibility to shift resources to react to unexpected intervening occurrences than would otherwise be possible, without establishing a broadened agency funds transfer authority.<sup>83</sup>

Of course, this advantage is diminished to the degree the Congress chooses to appropriate by specific program line items:

The current practice of appropriating funds for major procurement accounts by line items links projected costs for each item with the quantity to be procured. This can limit managerial flexibility in making adjustments, but some PPBS observers believe it can also provide an incentive for making accurate cost estimates and adhering to planned schedules. Accountability for estimates and plans forms the basis for the understanding between the executive and legislative branches on which the budget process is founded. When cost estimates provided in the budget presentation prove to be too low, for whatever reason, responsible officials must take action. Their choices may include making

changes to the item to reduce costs, if that can be accomplished without violating the terms of the original justification; returning to the Congress for either additional funding or approval of a different schedule; or finding a source for reprogramming, which must be cleared through numerous levels of approval. The time involved in making these choices and securing the necessary approvals can result in program delays and inhibit efficient program management. If either increased funding or reprogramming is selected, the Congress will receive requests that must be reviewed, heard, and decided. This increases the demands on its time and adds to the pressure to focus on details that may or may not have a direct application to major national policy considerations.<sup>84</sup>

It has been suggested that the strictures of detailed line iteming could be relaxed without sacrificing too much congressional control, by aggregating some procurement line items along generic lines while still separating the larger, high-visibility items, such as those covered in the Selected Acquisition Reports (SAR's).<sup>85</sup>

The congressional budgeting process is an attempt to harmonize the Congress' "institutional imperative" -- collegiality, based on the diffusion of power -- with the clear need for an integrated, fiscally-sound national budget. The extent to which it succeeds in this balancing of mutually antagonistic needs is the measure of success of the congressional budgeting process.<sup>86</sup>

## C. The Budget Execution Phase

Appropriations bills, when they are finally passed, limit expenditure authority by time, purpose and amount. Limitations on expenditure authority may be expressly stated in the General Provisions of particular appropriations acts, or limitations may be implicit in the type of funds appropriated. These limitations, discussed in Chapter III, have a direct effect on the implementation of procurement programs.

### 1. Congressional Controls Over Budget Execution

Once appropriation acts are passed, the funds pass to Executive administrative control, where they become subject to the elaborate apportionment, allocation, and suballocation processes prescribed by the OMB in OMB Circular A-34, as implemented by the various agencies' fiscal regulations.<sup>87</sup> Appropriations bills are typically divided into separate appropriation heads which generally state the purposes of the affected appropriations and the time period during which they are available for appropriation.<sup>88</sup> Funds are presumed to be appropriated for one year -- that is, to be "annual" funds -- unless some other period of availability is specified.<sup>89</sup> Legal principles concerning the availability of appropriations in time, purpose and amount are discussed in Chapter III.

## 2. Congressional Oversight of Major Systems

### Cost Growth

The budget execution phase is not free of close congressional review. In some major acquisition programs, budget execution may be halted if the program experiences excessive unit cost growth.

The Congress maintains a closer, continuing scrutiny of management performance on certain major defense acquisition programs through the required quarterly Selected Acquisition Reports (SAR's). The 1983 Defense Authorization Act required DOD to notify the Congress of cost growth exceeding certain thresholds. With the exception of systems excluded with the prior approval of the Senate and House Committees on Armed Services, all "major defense acquisition programs" must be reported to the Congress in accordance with detailed statutory requirements. These systems include all those specifically designated as major defense programs, or any programs estimated to require an eventual R&D total expenditure of more than \$200 million or procurement costs of more than \$1 billion.<sup>90</sup>

In addition, DOD is prohibited from obligating further funds after either 30 or 60 days from the date of report to the

Congress of excessive unit cost growth on either major defense acquisition programs in which unit cost growth has exceeded stated 15 or 25 per cent thresholds, with certain exceptions for cases in which the excessive cost growth is attributable to program termination or cancellation, or in which the program exhibiting excessive unit cost growth is certified by the Secretary of Defense to involve an essential program for which there exists no at least equally cost-effective alternative, and for which management cost controls are adequate.<sup>91</sup>

By the statute's terms,<sup>92</sup> the prohibition against further application of funds may be waived by the House and Senate Committees on Armed Services, acting together. This provision is a "legislative veto." The unit cost growth caused by the cancellation of the Air Launched Cruise Missile (ALCM-B) program illustrates the application of this prohibition. Unit costs soared since fixed costs could not be spread over as many units. The prohibition against obligation of further funds for the program was administratively interpreted to limit obligation only for more units, not to prohibit further obligations for equipment and spares to support units already procured.<sup>93</sup>

In addition, the Secretary of Defense is prohibited from approving either the full-scale engineering development



or the production and deployment of a major defense acquisition program without first securing, and considering, an independent cost estimate from "an office or other entity that is not under the supervision, direction, or control of the military department, defense agency or other component of the Department of Defense that is directly responsible for carrying out the development or acquisition of the program."<sup>94</sup>

## Chapter II: Footnotes

1. 31 U.S.C. § 1341. See generally, R. Nash and J. Cibinic, I Federal Procurement Law at 657-658 (1977).
2. 31 U.S.C. § 1103.
3. The Congressional Budget Office (CBO) was enabled by the Congressional Budget and Impoundment Control Act of 1974, Pub. L. No. 93-344, Title II, § 201, July 12, 1974, 88 Stat. 302, codified at 2 U.S.C. § 601-604.
4. 2 U.S.C. § 602 (f)(1).
5. 2 U.S.C. § 639.
6. 31 U.S.C. § 1102.
7. Prior to 1843, appropriations were made on a calendar year basis, see Act of August 26, 1842, Chap. 207, 5 Stat. 536.
8. Act of June 10, 1921, Chap. 18, § 201 (a), 42 Stat. 20, codified at 31 U.S.C. § 1105 (a).
9. 31 U.S.C. §§ 1105; GAO, A Glossary of Terms Used in the

Federal Budget Process and Related Accounting, Economic and Tax Terms 71 (3d ed. 1981), hereafter cited as Budget Terms.

10. Joint DOD/GAO Working Group on PPBS, The Department of Defense's Planning, Programming, and Budgeting System, GAO/OACG-84-5 at 7 (September, 1983), hereafter cited as DOD/GAO PPBS Study.

11. For a concise, although now perhaps somewhat dated, discussion of the Houses' rules, see Gallimore, Legal Aspects of Funding Department of the Army Procurements, 67 Mil. L. Rev. 102-107 (1975).

12. Pub. L. No. 93-344, July 12, 1974, 88 Stat. 302, codified in relevant part at 31 U.S.C. §§ 621-661. Legislative history may be found at 1974 U.S. Code, Cong. & Admin. News 3462.

13. 2 U.S.C. § 631.

14. 31 U.S.C. § 1110.

15. A. Schick, Congress and Money: Budgeting, Spending and Taxing 579 (1980)

16. Id. at 572.

17. Budget Terms at 49.
18. 2 U.S.C. § 634.
19. Budget Terms at 49.
20. Gallimore, note 11 supra at 99 & 101.
21. See Rule XXI, Rules of the House of Representatives, H.R. Doc. No. 384, 92d Cong., 2d Sess. 463 (1973); Rule XVI, Senate Manual, S. Doc. No. 91-1, 91st Cong., 1st Sess. 17 (1969).
22. Gallimore, note 11 supra at 100-101.
23. Id. at 101, citing Syphax's Case, 7 Ct. Cl. 529 (1871).
24. See A. Schick, Reconciliation and the Congressional Budget Process 41-42 (1981).
25. See Rule XXI, Rules of the House of Representatives, H.R. Doc. No. 384, 92d Cong., 2d Sess. 463 (1973); Rule XVI, Senate Manual, S. Doc. No. 91-1, 91st Cong., 1st Sess. 17 (1969).
26. Pursuant to 31 U.S.C. § 1106.
27. Budget Terms at 79.

28. 31 U.S.C. § 1107.

29. Reported Interview, "Alice Rivlin on the Budget," The Brookings Review 25, 27 (Fall, 1983)(emphasis added).

30. American Enterprise Institute, Proposals for a Biennial Budget 5 (1983).

31. A. Schick, Reconciliation and the Congressional Budget Process, note 24 supra at 7, 30 & 31.

32. Id. at 33.

33. Id. at 40.

34. Weinberger, 360 F. Supp. 724 (W.D. Okla. 1973).

35. 55 Comp. Gen. 289 (1975).

36. 62 Comp. Gen. 9 (1983); Comp. Gen. Dec. B-207281, October 19, 1982, unpub.

37. 52 Comp. Gen. 270 (1972); 52 Comp. Gen. 71 (1972).

38. Budget Terms at 44; Comp. Gen. Dec. B-206571, 61 Comp.

Gen. 473 (1982).

39. Comp. Gen. Dec. B-194063.2, May 1, 1979, unpub.

40. See, e.g., Air Force Regulation 177-16, "Administrative Control of Appropriations, August 13, 1980.

41. Puritano, Resource Allocation in the Department of Defense, 29 Armed Forces Comptroller 9 (1984).

42. GAO Report No. PAD-81-31, "Funding Gaps Jeopardize Federal Government Operations," March 3, 1981.

43. 43 Op. Att'y Gen. 1, 3 (1980).

44. GAO Report No. PAD-81-31, note 42 supra at 12.

45. Id. at 8.

46. McAvoy, Government Procurement Law LL.M. thesis submitted to the National Law Center, The George Washington University, "Contracting Prior to Appropriations," at 6 (1973).

47. 43 Op. Att'y Gen. 1 (1980)(emphasis added).

48. Id. at 5-6.

49. Id.

50. OMB Bulletin No. 80-14, "Shutdown of Agency Operations Upon Failure by the Congress to Enact Appropriations," August 28, 1980; OMB Memorandum, "Agency Operations in the Absence of Appropriations," September 30, 1980; OMB Memorandum, "Continuing Resolution," December 15, 1980.

51. GAO Report No. PAD-81-31, note 42 supra at 29, March 3, 1981; Comp. Gen. Dec. B-202135, December 10, 1981, unpub.

52. GAO Report No. PAD-81-31, note 42 supra; Opinion of the Attorney General to the President, January 16, 1981, reprinted in GAO Report No. PAD-81-31 at 77-92.

53. Opinion of the Attorney General, note 52 supra at 82.

54. For a subsequent illustration and application of this exception, see Comp. Gen. Dec. B-208985, October 29, 1982, unpub. (questioning whether all uniformed DOD personnel fell under the Antideficiency Act exception, "in cases of emergency involving the safety of human life or the protection of property.")

55. Opinion of the Attorney General, note 52 supra at 92.

56. GAO Report No. PAD-81-31, note 42 supra at 48-56.
57. Id. at 10.
58. GAO Report No. PAD-81-31, note 42 supra at 10-11.
59. Puritano, note 41 supra at 11.
60. HQ USAF/Comptroller, The Air Force Budget: FY 1984 89-98 (1983).
61. DOD/GAO PPBS Study, note 10 supra at 84-85.
62. Puritano, note 41 supra at 10.
63. Id. at 9.
64. C. Liske & B. Rundquist, The Politics of Weapons Procurement: The Role of Congress 4 (1974).
65. Id. at 75 (emphasis added).
66. Id. at 91.
67. Id. at 55.



68. Id. at 61-62.

69. A. Wildavsky, *The Politics of the Budgeting Process* 130-131 (1964), quoted in Steiner, "Problems in Implementing Program Budgeting," RAND Memorandum No. RM-4514-RC at 11-12 (1965).

70. DOD/GAO PPBS Study, note 10 *supra* at 24.

71. Assistant Secretary of the Navy (MRA&L), *Final Report of the Naval Ship Procurement Process Study* 55-57 (1978).

72. Federal Contracts Report, Multiyear Contracts -- Now You See It, Now You Don't, 39 Fed. Cont. Rep. 972, 973 (1983), quoting Slay, A New Look at an Old Remedy: Multiyear Contracts and Defense Procurement, 1982 Defense Management J. 20, 22.

73. J. Reece, *Dissertation Submitted to Harvard University Graduate School of Business Administration, "The Effects of Contracts Changes on the Control of a Major Defense Weapon System Program,"* at 2-12, 3-29, 3-30, 3-41 (1970).

74. Schutt & Acker, Program Stability: An Essential Element in Improved Acquisition, 5 Concepts 148, 150-151 (1982); *Statement of Under Secretary of Defense (Research and*

Engineering) to the 97th Congress, 2d Sess., "The FY 1983 Department of Defense Program for Research, Development and Acquisition," at III-3, March 2, 1982.

75. 2 U.S.C. § 623.

76. For an analysis of several recent congressional biennial budgeting proposals, see American Enterprise Institute, "Proposals for a Biennial Budget" (1983). There is a growing body of support in the Congress for budget process change, particularly for a biennial budget. See, e.g., these remarks on the House floor by Rep. Annunzio, in which he states four perceived problems with the current process (the timeframe is wrong; the economic assumptions are wrong; the process focuses on the wrong questions; micromanagement dominates the process):

I am talking today on the date when we were supposed to be passing the second concurrent resolution, at a time when we have not even passed the first concurrent budget resolution.

. . . .

[T]he timeframe for budgets is wrong. Annual budgets are doomed to fail. An annual budget maximizes the pain you are going to impose on any specific interest group by trying to change how much they get that year, maximizes the reward you get by giving them more and minimizes the time necessary to invest in the long run.

An apple orchard that is on an annual budget could never plant trees because they do not grow fast enough to give you apples that year. Any kind

of corporation that wanted to build a serious large factory could never operate on a purely annual budget because it would never get a return on that investment. It would be pure loss. We would never build our highways on an annual basis because you would never be able to get the concrete or the asphalt down to have cars riding on the entire highway.

The very concept of an annual budget is basically wrong, and a final example is the Defense Department. You cannot build aircraft carriers, buy airplanes, or buy tanks from an efficient assembly line or an efficient shipyard on an annual basis. We need to go toward a 2-year budget; we need to go toward a process of looking, frankly, further down the road on multiyear contracts, not just in defense but in a number of areas, and we need to get to a point where we distinguish between the kinds of changes that take time to pay off and the kinds of irrational shortsighted steps that we all too often take.

Benjamin Franklin once warned us against being penny-wise and dollar-foolish. And he was right. The fact is that we are all too often very wise with this year's budget's pennies in ways that cost us next year's dollars.

. . . .

The current annual cycle is so swamped in silly rules, technical procedures, and phony deadlines that it is self-defeating by its very nature. It guarantees that we will talk much about the budget without every really budgeting and that we will talk much about numbers without ever really changing them.

130 Cong. Rec. H9579, 9582 (Daily ed., September 14, 1984).

77. See, e.g., GAO Report No. PAD-81-61, "Multiyear Authorizations for Research and Development," June 3, 1981.

78. J. Bennett, dissertation submitted to the School of

Government and Business Administration of The George Washington University, "Department of Defense Systems Acquisition Management: Congressional Criticism and Concern," at 68 (1974).

79. Puritano, Resource Allocation in the Department of Defense, note 41 supra at 11.

80. Smithies, "A Conceptual Framework for the Program Budget," RAND Memorandum No. RC-4271-RC at 38.

81. DOD/GAO PPBS Study, note 10 supra at 119-123.

82. DOD/GAO PPBS Study, note 10 supra at 117.

83. Id.

84. Id. at 75-76.

85. Id. at 79-80.

86. A. Schick, *Congress and Money* 6-7 (1980).

87. See Chapter III.B.3.i.

88. See Chapter III.B.2.

89. See Chapter III.B.2.b.

90. 10 U.S.C. § 139a.

91. 10 U.S.C. § 139b.

92. 10 U.S.C. § 139b (e).

93. Memorandum, General Counsel of the Department of Defense for Mr. Place (SAF/GC), "Air Launched Cruise Missile (ALCM-B)," June 1, 1983; Memorandum, Office of the Air Force General Counsel (Fiscal Law) for Mr. Mitchell (SAFFM), "Unit Cost Reports," April 7, 1983.

94. 10 U.S.C. § 139c (b)(2).

## Chapter III. Fiscal Law: The Legal Limits

### A. Constitutional Principles

### B. Statutory and Regulatory Fiscal Law Principles

1. General Limits on Funds Obligation

2. Availability of Appropriations

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--The "bona fide needs" rule

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3. Basic Statutory Restrictions

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i. Antideficiency Act

### **III. Fiscal Law Principles -- The Legal Limits**

Now that the reader has some acquaintance with the budget formulation, authorization and appropriation processes, the limits imposed by the principles of fiscal law become relevant. These fiscal control laws have been enacted by Congress in its continuing effort to ensure that it does not lose control of the budgetary process during the execution phase.

To understand the necessity for the contracting techniques which are the subject of Chapter V, and their forms and evolution, the reader must also have an understanding of the constitutional, statutory and regulatory rules of fiscal law and the related principles of appropriation law which have been evolved and applied by the courts, the Comptroller General and the agencies.

#### **A. Constitutional Principles**

The United States Constitution gives control of disbursements to the Congress as a tool to enforce its policy choices. The efforts of the Legislative Branch to maintain its right to make fundamental policy choices for the nation has given birth

to much of this area of the law.

The Constitution invests the Congress with the "power of the purse," the power to dictate the purposes for which public monies will be spent and, implicitly, the amounts that may be spent, and the timing of expenditures. This power to specify funding purposes, levels and times of availability gives the Congress a great degree of control over the administration of government procurement programs.

The Constitution, in Article I, Section 8, Clause 1 gives to Congress exclusively the power to "lay and collect taxes, duties, imposts and excises to pay the debts and provide for the common defence and general welfare of the United States. . . ." Elsewhere in Article I, in Section 8, Clauses 12 and 13, the Congress is given the power to "raise and support armies, but no appropriation of money to that use shall be for a longer term than two years" and to "provide and maintain a navy." The United States Attorney General interpreted the two-year appropriation limit "to raise and support armies" as permitting longer-term appropriations to equip the military with the means to train and fight and, further, as having no application to no-year appropriations for the procurement of aircraft and aeronautical equipment.<sup>1</sup> The Congress is further empowered in Clause 18 of the same section to "make all laws which shall be necessary and proper



for carrying into execution the foregoing powers, and all other powers vested by this Constitution in the Government of the United States, or in any department or officer thereof." This clause gives the Congress power to dictate, in as great particularity as it deems necessary within broad constitutional constraints, the manner in which the other branches of the Federal Government and their agencies will execute their functions. Finally, but most importantly, the Congress is given exclusive control over all withdrawals from the public treasury in Article I, Section 9, Clause 6: "No money shall be drawn from the Treasury, but in consequence of appropriations made by law. . . ." This provision restricts the disbursing authority of the Executive Branch -- the power to make payments, not the power to enter into obligations that will later require payments.<sup>2</sup>

Thus, for almost all purposes, only the Congress is empowered to determine the purposes for which public funds may be expended, and to impose such limiting terms and conditions upon the use of public monies as it determines proper within broad constitutional limits. It has been argued that the Constitution, in requiring the President to do some act requiring the obligation of public funds, might also give the incumbent "inherent authority" to contract for that purpose despite the absence of prior congressional budget authority.<sup>3</sup> Certainly, as the Court stated in United States v. Tingey,<sup>4</sup>

the Executive Branch has inherent power to contract:

It is in our opinion an incident to the general right of sovereignty; and the United States being a bod' politic, may, within the sphere of the constitutional powers confided to it, and through the instrumentality of the proper department to wh ch those powers are confided, enter into contracts not prohibited by law, and appropriate to the just exercise of those powers.

This merely begs the question: To what extent are contracts prohibited by law and to what extent may authority to obligate the United States be implied? At first glance, it might seem simply that to the extent contracts violate the various fiscal control laws they are illegal and, therefore, any Presidential inherent power to contract seems to be limited to matters in which the Congress has not limited that authority. It is difficult to imagine that the Congress, in authorizing the government to negotiate contracts<sup>5</sup> and to issue procurement regulations<sup>6</sup> intended to permit the formation of contracts creating obligations beyond the scope imposed by the fiscal control laws.<sup>7</sup> Even though the power to make contracts necessarily comprehends the power to fix their terms,<sup>8</sup> as Tingey clearly says, the inherent power to contract cannot transcend limitations imposed by the Congress. Further, in Hoe v. United States,<sup>9</sup> the Court wrote

It is . . . clear that the Secretary could not, by his acts create a state of things which in the absence of legislation on the subject, an implied contract could arise under which the government

would be liable, by reason of its constitutional duty to make just compensation for the use of private property taken for public purposes. In such a case, the remedy is with Congress, not the courts.

. . .

On the other hand, some exercises of the Executive authority may permit the President some independent obligational authority, as the Attorney General maintains:

Unlike his subordinates, the President performs not only functions that are authorized by statute, but functions authorized by the Constitution as well. To take one obvious example, the President alone, under Art. II, § 2, cl.1 of the Constitution, 'shall have Power to grant Reprieves and Pardons for Offenses against the United States, except in Cases of Impeachment.' Manifestly, Congress could not deprive the President of this power by purporting to deny him the minimum obligational authority sufficient to carry this power into effect. Not all of the President's powers are so specifically, enumerated, however, and the question must consequently arise, upon a Government-wide lapse in appropriations, whether the Antideficiency Act should be construed as depriving the President of authority to obligate funds in connection with those initiatives that would otherwise fall within the President's powers.

In my judgment, the Antideficiency Act should not be read as necessarily precluding exercises of executive power through which the President, acting alone or through his subordinates, could have obligated funds in advance of appropriations had the Antideficiency Act not been enacted. With respect to certain of the President's functions, as illustrated above, such an interpretation could raise grave constitutional questions. It is an elementary rule that statutes should be interpreted, if possible, to preclude constitutional doubts, Crowell v. Benson, 285 U.S. 22, 62 (1932), and this rule should surely be followed in connection with a broad and general statute, such as 31 U.S.C. § 665(a), the history of which indicates no congressional consideration at all of the desirability of limiting otherwise

constitutional presidential initiatives. The President, of course, cannot legislate his own obligational authorities; the legislative power rests with Congress. As set forth, however, in Mr. Justice Jackson's seminal opinion in Youngstown Sheet & Tube Co. v. Sawyer, 343 U.S. 579, 593 (1952):

The actual art of governing under our Constitution does not and cannot conform to judicial definitions of the power of any of its branches based on isolated clauses or even Articles torn from context. While the Constitution diffuses power the better to secure liberty, it also contemplates that practice will integrate the dispersed powers into a workable government. It enjoins upon its branches separateness but interdependence, autonomy but reciprocity. Presidential powers are not fixed but fluctuate, depending on their disjunction or conjunction with those of Congress.

Id. at 635 [citing Nixon v. Administrator of General Services, 433 U.S. 425, 443 (1977); Buckley v. Valeo, 424 U.S. 1, 122 (1976); United States v. Nixon, 418 U.S. 683, 707 (1974); National Ass'n of Letter Carriers v. Austin, 418 U.S. 264, 273 n.5 (1974)]. Following this reasoning, the Antideficiency Act is not the only source of law or the only exercise of congressional power that must be weighed in determining whether the President has authority for an initiative that obligates funds in advance of appropriations. The President's obligational authority may be strengthened in connection with initiatives that are grounded in the peculiar institutional powers and competency of the President. His authority will be further buttressed in connection with any initiative that is consistent with statutes -- and thus with the exercise of legislative power in an area of concurrent authority -- that are more narrowly drawn than the Antideficiency Act and that would otherwise authorize the President to carry out his constitutionally assigned tasks in the manner he contemplates. In sum, with respect to any presidential initiative that is grounded in his constitutional role and consistent with statutes other than the Antideficiency Act that are relevant to the initiative, the policy objective of the Antideficiency Act must be considered in undertaking

the initiative, but should not alone be regarded as dispositive of the question of authority.

Unfortunately, no catalogue is possible of those exercises of presidential power that may properly obligate funds in advance of appropriations [citing 30 Op. Att'y Gen. 343, 347-48 (1939)]. Clearly, such an exercise of power could most readily be justified if the functions to be performed would assist the President in fulfilling his peculiar constitutional role, and Congress has otherwise authorized those or similar functions to be performed within the control of the President. Other factors to be considered would be the urgency of the initiative and the likely extent to which funds would be obligated in advance of appropriations.<sup>10</sup>

However, for other Executive Branch obligations of the United States not springing from some constitutionally independent Executive power, congressional limitations of obligational authority clearly apply. Congressional limitations are often stated in appropriations acts themselves. Such limitations may be stated in terms which will restrict their application to the funds appropriated in that act, or they may be stated in general terms unrestricted by time or the appointed use of the funds appropriated.<sup>11</sup> Such fiscal limitations may also be enacted into separate, permanent legislation, and some of the most fundamental statutory fiscal control limitations will be discussed in the next section.

## B. Statutory and Regulatory Fiscal Law Principles

### 1. Limits on Funds Obligation and Expenditure

As a general principle, government agencies have no authority to form legal obligations except when acting within the limits of budget authority created by Congress.

Budget authority is authority to enter into obligations that will result in immediate or future outlays of federal funds and may be either (1) implied from appropriations, (2) express contract authority,<sup>12</sup> or (3) borrowing authority.<sup>13</sup> Appropriations permit obligations and payments to be made, but contract authority permits only obligation of public funds -- payment may not be made except by the authority of a later appropriation of funds. Because both contract authority and borrowing authority are by definition unfunded when created, and must be funded later if resulting obligations are to be satisfied, they are often referred to as "backdoor" budget authority. When express contract authority is provided, then the limitations associated with the budget authority implied from appropriations do not apply.<sup>14</sup> But where the authority to contract is solely that implied from an appropriation of funds, "where . . . liability rests wholly upon the authority of an appropriation they must stand and fall together, so that

when the [appropriation] is exhausted the [obligation] is at an end."<sup>15</sup>

Government liability may not be concluded, however, since it is sometimes possible for contractors to recover -- sometimes on a quantum meruit or quantum valebant theory, sometimes on the contract -- despite violations of fiscal control laws.

Generally, an obligation is a commitment that will ultimately result in disbursement of funds. An obligation occurs when a binding contract is formed; expenditure occurs when payment is made.<sup>16</sup> Since the federal government uses an obligation-based system -- as opposed to a cost-based system -- it is necessary to clearly distinguish between obligations incurred and payments made. "Obligation incurred" might be defined as

[a]mounts of orders placed, contracts awarded, services received, and similar transactions during a given period that will require payments during the same or a future period. Such amounts will include outlays for which obligations had not been previously recorded and will reflect adjustments for differences between obligations previously recorded and actual outlays to liquidate those obligations.<sup>17</sup>

The term "outlays" refers to the liquidation of obligations by the issuance of checks or the disbursement of cash, and is synonymous with "expenditure" or "payment."<sup>18</sup>

Most commonly, budget authority is created by passage of an appropriation act. There are thirteen regular appropriation acts enacted each year, and they appropriate funds not for the "current year" -- which is the fiscal year in progress -- but for the "budget year," that is, the fiscal year following the current year. The "prior year" refers to the fiscal year immediately preceding the current year.<sup>19</sup> Three basic types of appropriation are used: annual, multiple-year and no-year appropriations. In addition, revolving funds are used.

Funds can be appropriated for the use of one period but charged to another period, too. Advance funding is budget authority created in an appropriation act to obligate and disburse funds during a fiscal year from a succeeding year's appropriations. Advance funding is regarded as a device to avoid supplemental requests late in the fiscal year for entitlement programs should the funds appropriated in the current year turn out to be too little.<sup>20</sup> Advance appropriations are budget authority created in an appropriation act to become available in one or more fiscal year beyond the fiscal year for which the appropriation act is passed. Naturally, advance funding increases the budget authority for the year in which it is obligated and reduces the budget authority of the succeeding fiscal year, while an



advance appropriation is not included in the budget totals for the year it is enacted, but is rather included in budget totals for the fiscal year in which the amount will become available for obligation. By contrast, forward funding refers to multiple-year availability for obligation,<sup>21</sup> that is, authority in appropriations acts to obligate funds in one fiscal year for the financing of programs in succeeding fiscal years. Forward funding is sometimes used where the program year differs from the federal fiscal year, as with some educational programs, so that grants can be made in time to finance an entire school year. Although such funds straddle fiscal years in that they are made available for obligation during some portion of the succeeding fiscal year, they are often limited in availability until after some date in the budget year, e.g., to be available 1 July through 30 December.<sup>22</sup> Bulk funding is commonly used with small purchase procedures to acquire supplies, nonpersonal services and minor construction from commercial sources when the aggregate amount does not exceed \$25,000, permitting contracting officers to obligate funds on purchase documents against a specific lump sum of funds reserved for a specified purpose for a specified time period rather than seeking obligational authorization for each purchase agreement.<sup>23</sup>

Annual budget authority, also called one-year authority, is simply available for obligation only during a

specified fiscal year and expires at the end of that time. Multiple-year budget authority is available for obligation for some specified period greater than one year, while no-year budget authority remains available for an indefinite period of time usually considered to end when Congress' purpose has been attained or when it has been inactive for two consecutive years. This is referred to as a "write-off," and is required by 31 U.S.C. § 1555.<sup>24</sup>

By way of distinction, "expired accounts" are those in which the authority to incur obligations has lapsed but from which outlays may be made to pay existing obligations and liabilities previously incurred, as well as adjustments to these amounts. Annual and multiple-year appropriations expire for purposes of obligation -- but not payment -- at the end of the period for which appropriated.

Expired appropriations retain their original identification -- for the Air Force, agency prefix 57, fiscal year or years, and appropriation symbol -- for two years after expiration. On September 30 of that year, the appropriation is said to "lapse," and total unliquidated (unpaid) obligations are withdrawn by the Treasury, subject to restoration to liquidate obligations and to effect adjustments. Upward adjustments in certified obligations are chargeable to unobligated balances available for restoration

from Treasury at the appropriation level -- and to ensure that funds are available for restoration when needed later, contingent liabilities should be covered by funds commitments during the life of the appropriation, so that later they will be available for restoration from the appropriations' withdrawn unobligated balances. Generally, in no event may obligations or expenditures exceed appropriations available for that time or purpose.

The obligated balances of all these forms of budget authority are merged into "M" accounts, successor accounts, which remain available for the payment of obligations and liabilities charged or chargeable to various years' appropriation accounts; these include successor accounts established pursuant to 31 U.S.C. § 1551-1558. Sometimes the adjustments are downward and referred to as "recoveries of prior-year obligations."<sup>25</sup>

"Merged surplus accounts" are part of the Treasury's general fund comprised of undisbursed and unobligated balances of prior years' appropriated funds -- they are maintained by appropriation type, by agency, without regard to the fiscal year of the appropriation and can be "restored" (made available again for obligation and expenditure) to pay obligations contained in the "M" accounts. This authorizes an agency "to adjust upward previously underrecorded obligations

that should have been recorded against an expired appropriation before its expiration (but were not) without an additional appropriation. Without restoration authority a new appropriation would be necessary since the agency's current appropriation would not be available."<sup>26</sup>

Loss of availability at the end of the originally-assigned period of availability is not inevitable, however. Unobligated balances of prior years' appropriations may be "reappropriated" for the same or different purposes.<sup>27</sup>

One further semantical distinction should be drawn at this point, between supplemental and deficiency appropriations and apportionments, although the distinction seems less clear in practice. A deficiency appropriation is made to an expired account to cover obligations incurred in excess of available funds -- to "cure" Antideficiency Act violations. By contrast, supplemental appropriations provide funds in excess of original estimates when the need for funds is so urgent it can't be postponed until the next regular appropriations bill -- these sometimes include items not appropriated in the regular bills because they were not preceded by timely authorizations.<sup>28</sup> A deficiency apportionment is a distribution of obligational authority by OMB that anticipates the need for a later supplemental appropriation -- Antideficiency Act violations are avoided by reducing the

fourth quarter apportionment to reflect the deficiency rate of obligation.<sup>29</sup>

So, in summary, "time-limited" funds include annual and multiple-year appropriations. Annual appropriations are made to meet an agency's expenses for one fiscal year as projected in the President's annual budget submission, to the extent approved by Congress. If annual funds are not fully obligated for a bona fide need of that fiscal year within that year, the unobligated portion expires -- it is not available for obligation any longer. However, although annual funds must be properly obligated within the intended fiscal year to prevent expiration, actual payment (expenditure) need not occur within that fiscal year. Multiple-year appropriations are available for obligation for some specified number of years, and for expenditure beyond those years. No-year appropriations are not limited by time -- such funds are usually available for obligation and expenditure until fully obligated, expended, their purpose is achieved, or they become inactive.

Regardless which form of time availability restraint is used by Congress, rarely is a sum larger than that estimated to be needed for one year's requirements actually supplied by Congress to the agencies.

Revolving funds are used with federal agency operations that generate income. The agency is sometimes empowered to use the income to finance the operation's continued functioning.<sup>30</sup> There are three types of revolving funds: public enterprise, intragovernmental, and trust. In each type, collections are netted against spending and outlays are reported as the net amount.<sup>31</sup>

Budget authority is not available for use by the agencies until the appropriated funds have been apportioned by the Office of Management and Budget (OMB), under a system created by 1951 amendments to the Antideficiency Act to permit executive branch control over obligation and expenditure by the executive agencies.<sup>32</sup> Apportionment is generally made on a quarterly basis to prevent over-expenditure early in the fiscal year which would require either curtailing agency programs or passage of supplemental or deficiency appropriations to carry on affected agency programs.

OMB has authority, in 31 U.S.C. § 1512 (c), to establish reserves from appropriated funds to cover anticipated contingencies or to effect savings. Partly to control executive impoundment (refusal to spend) based on this authority, the Congressional Budget and Impoundment Control Act of 1974<sup>33</sup> was enacted. In addition to establishing the budget process, this act -- in Title X -- requires

congressional approval of executive impoundments of funds, and establishes a procedure for congressional consideration of executive rescissions, reservations or deferrals of budget authority to prevent unilateral Executive Branch evisceration of congressionally-approved programs. The President is required to notify the Congress of proposed rescissions or deferrals, and the Comptroller General reviews the proposals for the Congress.<sup>34</sup>

Presidential impoundment of funds provided for particular activities had been increasingly used to achieve the effect of a "line item veto," permitting the Executive Branch to discretionarily accept some, but not all, of the duties imposed by the Congress' policy choices enacted into legislation.

Under the Act, attempted executive rescissions and reservations must fail under this procedure, unless Congress enacts a rescission bill within 45 days of the executive request for such authority. A "legislative veto" was retained as to temporary funds detentions: attempted executive deferrals must fail if either House of Congress passes a disapproving resolution. The Congress lost the legislative veto device as a consequence of INS v. Chadha, 454 U.S. 212 (1983) and, presumably, the Congress will take some action to restore its power in this area, since this "veto" power has

been used in this area at least sixty-five times since its enactment.<sup>35</sup>

Now, at least as to rescissions not supported by the Congress, the originally-appropriated budget authority must be made available to the affected agency for obligation, and if the executive branch fails to do so, the Comptroller General may bring a civil action to compel release of the budget authority for obligation and expenditure in accordance with the policy choices of Congress.<sup>36</sup> Of course, not all failures to fully obligate appropriated funds are reportable rescissions. As noted earlier, unobligated funds "lapse" generally two years after their period of availability. Such lapses can be caused by program changes decreasing the need for funds, by simple agency caution to avoid over-obligations, by intervening legislative acts precluding certain obligations, by appreciation of the dollar, by "recapture" of budget authority, and by Executive policy changes (such as the 1981 federal hiring freeze). Of these causes of lapses, only the last would generate reportable rescissions.<sup>37</sup>

## **2. Availability of Funds: Appropriation Act Interpretation**

Appropriations are available for only the purposes, times, and amounts specified by Congress in appropriation



acts.<sup>38</sup> The Comptroller considers these three limits to be the "elements" of availability.<sup>39</sup>

An act of Congress is an appropriation act only if it contains specific appropriating language:

A law may be construed to make an appropriation out of the Treasury or to authorize making a contract for the payment of money in excess of an appropriation only if the law specifically states that an appropriation is made or that such a contract may be made.<sup>40</sup>

This means that authorization acts do not create budget authority, unless unfunded contract or borrowing authority is created,<sup>41</sup> although authorization acts may well restrict availability of the later-enacted appropriations.<sup>42</sup>

Appropriation acts are normally preceded by authorization acts, but if an appropriation act makes a specific reference to a program not previously authorized, it will create budget authority for that program as effectively as if it had been previously authorized. Of course, the appropriation act will be subject to a point of order under Senate and House rules but, if passed, the act will still validly create budget authority.<sup>43</sup> However, mere inclusion of a program in a budget request may not be enough, at least unless it is an activity the agency has long performed without objection.<sup>44</sup>

While authorization and appropriation acts will generally be construed to give effect to both, to the extent they conflict the appropriation act will prevail.<sup>45</sup> This rule might cause line-item restrictions in an authorization act to be applied to an apparently unrestricted lump-sum appropriation,<sup>46</sup> and this will clearly be the effect when the authorization act creates or amends permanent law.<sup>47</sup>

Interpretation of appropriation acts, like other statutory interpretation, has as its chief goal determination of legislative intent and, following the usual rules of statutory construction, the words of the act will be the primary determinant.<sup>48</sup> The legislative history may be considered,<sup>49</sup> but a limitation stated only in the act's legislative history will not restrict availability of an apparently unrestricted appropriation in a strictly legal sense, although it may well restrict its availability in a practical, inter-Branch political sense.<sup>50</sup>

Most of the rules surrounding fiscal law principles affecting the use of appropriated funds derive from statutory law. These rules can be roughly gathered into three classes of fiscal restraints that apply to both expenditure of appropriations and to the implied contract authority arising from the appropriations -- restraints on the purposes for

which they may be obligated or expended, the times during which they may be obligated or expended, and the amounts which may be obligated or expended. I have attempted to group the most basic fiscal control statutes according to this functional organization, recognizing that such a conceptual scheme cannot be perfectly exclusive since all the statutes interrelate to varying degrees: it has often been possible to decide controversies on the basis of several of the statutes and, in fact, the decisions frequently have been based several statutory sources of law without distinguishing among them.

Before beginning extended discussion of the most basic fiscal control statutory sources of law, the reader may find it useful to read the following brief summary of some of the basic themes which arise in the extended discussion, to become familiar with the topical inclusiveness of the purpose, time, amount categorization.

**a. Appropriations Availability Restrained By  
Purpose**

Proper purposes for which an appropriation may be obligated or expended generally include only those purposes toward which Congress intended the appropriation be applied and those subsidiary, implied objects which must necessarily be attained to achieve the goals Congress has approved.<sup>51</sup> To

achieve its purposes, Congress sometimes "earmarks" funds for particular line items in appropriation acts which produces "specific purpose" appropriations, and sometimes Congress permits broad administrative discretion in lump-sum "general purpose" appropriations.

To determine the purposes for which appropriations are available, regardless whether a "general purpose" or a "specific purpose" appropriation is used, the inquiry is the same: one must focus on whether an expense is "reasonably related to and necessary for the accomplishment of the stated purpose. To the extent that purpose is narrowly stated and specific, what is related and necessary to it will be more restrictively interpreted."<sup>52</sup>

However, where funds have been appropriated for a "specific purpose," only those amounts and no more may be obligated for that object, and general purpose appropriations may not supplement them. For example, the Comptroller has decided that a general purpose appropriation cannot be used to fund a judgment against a specific purpose appropriation even though the judgment created a deficiency in that account because the permanent indefinite judgment fund created by 31 U.S.C. § 1304 was not available in land condemnation cases, and specific purpose appropriations must be used rather than any general purpose budget authority which might also be

construed broadly enough to cover those same purposes.<sup>53</sup>

Appropriations are only available for the purposes the Congress has specified. The Congress may specify only generally, or in great detail, the purposes, programs or organizational units for which appropriations are made. So, a statement of purpose is at once a grant of authority and a statement of one of the limits on that authority. However, as seen above, the degree to which a statement of purpose actually legally restricts availability varies, depending on its specificity, and whether it appears in legislative history, authorization acts, or in appropriations acts themselves.

Appropriation heads generally describe the purposes for which funds are available, including personnel, operation and maintenance, procurement, and research and development. Construction activities of the military services are generally provided for in separate military construction authorization and appropriation acts. These heads can be further specified, making available specific amounts to particular programs or to particular agency organizational elements, although lump sums are generally used to allow some degree of administrative flexibility to accommodate the unforeseen. Appropriations for the procurement of supplies, services, research and development, ships, aircraft and missiles are most frequently

general purpose appropriations, although provisos sometimes impose ceilings and other program choices with some specificity.<sup>54</sup>

The General Provisions of appropriations acts are often called "legislative riders" -- they state numerous explicit limitations on the proper use of the appropriations, and some have permanent effect. For example, in the FY 1984 DOD appropriation act there were 99 sections in the General Provisions, including, for example:<sup>55</sup>

§ 702 -- publicity or propaganda limited to purposes authorized by the Congress;

§ 707 -- specifically making appropriations "for the current fiscal year and hereafter" for maintenance or construction available to acquire "any interest in land" as authorized in 10 U.S.C. §§ 2672, 2675 or 2828, including some multi-year leases abroad.

§ 708 (j) and (n) -- allowing leases of real and personal property (and maintenance thereof) and payments for depot maintenance contracts for "twelve months beginning at any time during the fiscal year;"

§ 712 -- permitting the President to exempt from apportionment certain appropriations, funds or contract authorizations, and to increase personnel levels and airborne alerts beyond levels appropriated;

§ 721 -- limiting foreign sourcing for food, clothing, cotton, silk, specialty metals;

§ 728 -- limiting payment of defense contractors' advertising costs;

§ 729 -- setting general transfer authority ceiling of \$1.5 billion between appropriations or funds or any subdivision thereof, to be merged with and to be available for the same purposes and for the same time period as the appropriation or fund to which transferred;

§ 730 -- restricting transfers between stock funds and industrial funds;

§ 734 -- research involving uninformed or nonvoluntary human beings as experimental subjects limited, but permitted when intended to be beneficial and consent obtained;

§ 778 -- prohibiting leases or charters for contracts of three or more years duration (including options) when

estimated termination liability exceeds 50 per cent of purchase value, unless the Congress has specifically provided for obligation of 10 per cent of that termination liability (see also 10 U.S.C. § 2401);

§ 791 -- limiting use of dogs and cats for treatment of wounds training;

§ 794 -- requiring written guarantees on weapons systems;

§ 797 -- encouraging dual sourcing for acquisition programs.

Agencies do have limited flexibility to apply appropriations to purposes other than those Congress has specified.

In DOD, funds in general purpose appropriations may be "reprogrammed," to move funds from one program to another within an appropriation account by obtaining the approval of the Appropriations and Armed Services Committees of the Senate and House of Representatives.<sup>56</sup> Congressional concurrence is not a prerequisite to all reprogrammings, and the Comptroller has decided that agency failure to follow reprogramming procedures will not justify contract cancellation for



illegality because -- in the case of the DOD reprogramming directives -- these "DOD directives, unlike laws and regulations, do not provide this Office with a proper basis for determining the legality of expenditures."<sup>57</sup> Apparently the Comptroller believes these directives are merely internal administrative regulations which may be waived by the agency.<sup>58</sup>

In addition to reprogramming authority, Congress creates administrative flexibility by appropriating contingency funds, by permitting intraservice administrative allotments, and by expressly authorizing transfers between appropriations accounts from time to time in both regular and supplemental appropriations acts.<sup>59</sup>

**b. Appropriations Availability Restrained By  
Time**

Generally, time limitations apply to availability of funds for obligation, but not for expenditure. Time-limited funds may be disbursed after the specified period of availability to satisfy obligations validly assumed during the specified period.<sup>60</sup>

Multiple-year and no-year funds are generally subject to the same fiscal control rules as annual funds, except for

their longer specified periods of availability for obligation. No-year appropriations usually contain such words as "to remain available until expended" or "without fiscal year limitation," although there are some permanent statutory exceptions such as 31 U.S.C. § 1307 which essentially makes no-year all appropriations for public building construction.

Many agencies' appropriations acts essentially provide that appropriated funds shall be presumed to be available for only one year, unless specified otherwise. Language such as this general provision is commonly included in appropriations acts:

No part of any appropriation contained in this act shall remain available for obligation beyond the current fiscal year unless expressly so provided herein.<sup>61</sup>

Since appropriations are available for only one year unless stated otherwise, DOD appropriations acts make annual appropriations -- usually lump-sum -- "for the fiscal year ending September 30" in

Title I: Military Personnel, expenses for each of the services, including pay, clothing, subsistence, travel expenses;

Title II: Retired Military Personnel, pay;

Title III: Operation and Maintenance, including funds for services, supplies and equipment, the services' stock funds, administration, medical care, communications, transportation, maintenance of equipment and facilities, recruiting, hazardous waste restoration;

Title VIII: certain Intelligence activities.

Multiple-year funds are commonly provided -- and sometimes transferred from previous appropriations -- in

Title IV: three-year funds for Procurement, including major items such as weapons systems and their spare parts and accessories, equipment, appliances and machine tools for public and private plants;

Title V: two-year funds for Research and Development are specified for each of the services, sometimes dictating program choices in considerable detail;<sup>62</sup>

Title VI: two-year funds for the Special Foreign Currency Program; and

Military construction funds are generally made available for five-year periods.

Multiple-year funds are provided in amounts sufficient for one year's "requirements" at a time, although they permit more than one year in which to obligate the funds.

Time-limited funds limited in availability for obligation to a specified time period are available for obligation only to meet the real, or bona fide, needs of the period for which they were appropriated. If not validly obligated within that time, such funds are said to "expire" -- although validly obligated amounts remain available indefinitely for payment. No-year appropriations are not limited either by period of availability or by the bona fide needs rule.

So, in general, a contract based on the implied contractual authority of an appropriation limited by period of availability which purports to procure goods or services greater than required for the funded period violates both the bona fide needs rule and the antideficiency laws because no appropriation is yet available to procure any other period's needs.

## The "Bona Fide Needs" Rule

The crucial distinction of the bona fide needs rule is that, in order to qualify as a bona fide need of a particular fiscal year, that need have have been current at the time the obligation was incurred -- at the time a legally binding obligation was incurred.<sup>63</sup> Time-limited funds may not be used to buy goods or services to satisfy other periods' requirements or to satisfy obligations incurred for previous periods' requirements.<sup>64</sup> The cardinal principle underlying the bona fide needs rule is that the need must have arisen during the period of availability, but not so close to the end of the period that performance may not possibly occur in period sought to be charged.<sup>65</sup> The goods or services may be delivered or used in subsequent fiscal years,<sup>66</sup> unless too long a gap exists (more than a year, Profs. Nash and Cibinic suggest) between obligation and performance, in which case the contract may be held not to have been let to fulfill a bona fide need of the period in which the obligation was incurred.<sup>67</sup>

The bona fide needs rule evolved as a pragmatic policy rule designed to restrain federal obligations to a new fiscal year system, which now dates back at least to the 1870's:

Formerly . . . but slight attempts were made to keep these accounts of the government by fiscal years. . . . But the recent policy of the Congress has been to keep the public accounts by the fiscal year; and now a department is credited with no balance over, and every expenditure is charged, not to transportation generally [for example], but to the transportation of that specific fiscal year for which that specific appropriation was made.

. . . Congress has restricted in every possible way the expenditures and expenses and liabilities of the government, so far as executive offices are concerned, to the specific appropriations for each fiscal year.<sup>68</sup>

But the bona fide needs rule is no obstacle to the payment or performance of a contract in periods subsequent in which the contract was formed (and to which the obligation will be charged), so long as the obligation was valid -- the need must have arisen during the specified period of availability and continued into the fiscal year in which performance will be rendered or payment made. Nor is the rule any obstacle to a contract in one fiscal year for deliveries in another when the goods will not be obtainable at the time in the later fiscal year when needed, and the intervening time will be required for production or fabrication.<sup>69</sup>

However, material needed on a periodically recurring basis may only be acquired on a one-year basis because only those needs will be considered bona fide needs of the year in which the contract is made.<sup>70</sup> Absent specific statutory authority, a multi-year contract to be funded with annual funds of the first contract year violates both the bona fide

needs rule and the Antideficiency Act: the contract purports to obligate one fiscal year's annual funds for needs beyond that year's needs, and to that extent it purports to obligate those funds beyond their availability.<sup>71</sup> On the other hand, if an agreement creates no real legal obligation, as in the case of an indefinite quantity requirements contract that is not enforceable by either party because it lacks the consideration of a promise not to procure requirements elsewhere, the Comptroller has decided that since obligations only arise when orders are actually placed under the agreement there is no violation of either rule.<sup>72</sup>

Statutory exceptions to the bona fide needs rule have been created. DOD long has had authority to contract for 12 month periods beginning in some fiscal year and to expend the appropriations current when the obligation is incurred for certain goods and services, including maintenance of tools and facilities, lease of real or personal property, and depot maintenance contracts.<sup>73</sup> In addition, certain depot maintenance contracts of previous years may be financed with current year funds.<sup>74</sup>

The bona fide needs rule -- when applied to services contracting -- requires distinguishing between services that are "severable" into separate fiscal years' efforts, and services that are "entire" (or "nonseverable") in the sense

that they cannot be separated for performance into separate fiscal years. Where severable, the appropriations current at the time the services are performed will be charged;<sup>75</sup> and where nonseverable, the appropriations current at the time the contract is formed are chargeable.<sup>76</sup>

**c. Appropriation Availability Restrained By  
Amount**

The primary statutory amount restraint on availability of appropriations is the Antideficiency Act which, in its present embodiment,<sup>77</sup> prohibits making payment or committing the government to make payments unless sufficient funds are available beforehand to pay. A contractor whose contract is funded under a general appropriation without actual or constructive notice of funds limitations may recover damages for breach of contract in the Claims Court should the appropriation become exhausted, while a contractor with notice of the limited funds available for his contract will find his contract illegal and unenforceable to the extent of the overobligation -- and any over-expenditures can be recouped from that contractor by set-off or other means.<sup>78</sup>

The full, ultimate costs of procured items are often not recorded as obligations of the government precisely because these costs often vary as contracts are executed.



Because the obligation of the government often varies either up or down from the original estimates as its contracts are executed -- due to such factors as escalation, changes, option exercises, new or greater requirements, termination charges, and fluctuation in currency exchange rates -- sometimes amounts initially appropriated become insufficient to cover all obligations as they become due. In that event, agencies find it necessary either to reduce the affected accounts obligational level by partial or complete termination of some contracts, to reprogram other available funds, or to request supplemental or deficiency appropriations.

One of the contractual devices used to cope with risks of unusually hazardous activities, varying government needs and uncertain funds availability is the contingent contract. This term includes indemnity and indefinite delivery contracts. Generally, with contingent contracts, it is held that the government has not entered into a binding obligation until the contingent, uncertain event occurs.<sup>79</sup>

The "continuing" contract -- founded on express grants of contract authority -- is another device that has been used to secure goods or services needed for several years. Where contract authority -- specific statutory authority to enter contracts in advance of appropriations -- has been created, the Comptroller formerly required agencies to include a "funds

available" clause making the government obligation contingent on future availability of funds, but he has since relieved agencies of that requirement where they were operating under express contract authority.<sup>80</sup> Contract authority sometimes may be transferred between agencies when one acts as the agent of the other.<sup>81</sup>

The Comptroller has disapproved attempts to use time-limited appropriations as a basis for entering contractual commitments that exceed the availability period of the funds. While such arrangements may be entered into using no-year funds, the Comptroller has refused to sanction incremental funding even from no-year appropriations accounts (such as the automatic data processing fund created by 40 U.S.C. § 759(c)), and instead insists that enough unobligated funds be available in the fund to satisfy the full obligation before it is entered.<sup>82</sup>

An attempt to obligate time-limited funds beyond their period of availability will run afoul of the rule in Leiter v. United States,<sup>83</sup> and result in the imposition on the contractor of a determination that an obligation binding on the government has been created only for the period of availability, with an option for renewal in the government that can only be exercised by an affirmative act by a government agent acting under the implied authority to

contract given by the newly-available appropriations for the subsequent period of availability. Contracts may provide for performance to begin immediately upon the enactment of an appropriations act, although payment may not be made until the funds actually become available through the administrative apportionment, allocation, and allotment system.<sup>84</sup>

When time-limited funds are used, contractually-agreed termination charges exceeding the termination for convenience measure of recovery are held by the Comptroller to be void at least to that extent, because such excess charges represent partial payment for unused future years' goods or services, and thus violate both the bona fide needs rule and the Antideficiency Act.<sup>85</sup>

Contracts may be valid at their inception but later become the bases for Antideficiency Act violations, depending on the government's exact contractual obligations and the status of the funds used to support the contracts.<sup>86</sup> For example, where the contract requires either of two alternative performances, no violation occurs if the government has enough funds to satisfy the lesser of the two. In one case where a contract permitted either full performance or payment of the difference between the higher contract price and the lower market price for synthetic fuels, no violation occurred if funds were available to pay the lesser amount.<sup>87</sup>

### 3. Basic Statutory Restrictions

To guide and restrain the executive agencies, Congress has enacted various fiscal limitations into permanent law, in addition to those fiscal restraints which may be found in appropriations acts.<sup>88</sup>

In fact, there are many permanently-enacted funding statutes, some of which may be found in Title 31, United States Code, and many of them interrelate. The Comptroller General has stated some of the statutory limitations peculiar to the use of time-limited appropriations this way:

These statutes evidence a plain intent on the part of Congress to prohibit executive officers unless otherwise authorized by law, from making contracts involving the Government in obligations for expenditure or liabilities beyond those contemplated and authorized for the period of availability of and within the amount of the appropriation under which they are made [apparently referring to then 31 U.S.C. § 665 (a) (now § 1341 (a)) and § 712a (now § 1502), and 41 U.S.C. § 11]; to keep all the departments of the Government in the matter of incurring obligations for expenditures, within the limits [apparently referring to the former 31 U.S.C. § 665 (a)] and purposes [apparently referring to the former 31 U.S.C. § 628 (now § 1301)] of appropriations annually provided [emphasis added] for conducting their lawful functions, and to prohibit any officer or employee of the Government from involving the Government in any contract or other obligation for the payment of money for any purpose in advance of appropriations made for such purpose [apparently referring to the former 31 U.S.C. § 665 (a)]; and to restrict the use of annual appropriations to expenditures required for the

service of the particular fiscal year for which they are made [apparently referring to the former 31 U.S.C. § 712a].<sup>89</sup>

The Comptroller went on to comment:

We recognize that the statutory restrictions imposed on contracts entered into under authority of fiscal year [time-limited] appropriations may give rise to difficult procurement problems, with reference to activities conducted by the Air Force in isolated areas, and that the making of extended term contracts in such areas could produce more favorable bid prices to the Government. However, the authority for such action is a matter for consideration by the Congress and may not be accomplished indirectly by a pattern of contracting which seeks to make use of requirements contracts extending beyond the current fiscal year to meet such situations.<sup>90</sup>

Despite these objections of illegality, the Comptroller did not object to the completion of the initial year's term in that case, "subject to the understanding that if the Department's requirements for this type of service cannot be met on an annual basis with renewal options from year to year, specific statutory authority for long-term contracts should be requested of the Congress."<sup>91</sup>

The reader should note that not all appropriations are subject to the full panoply of fiscal control laws. "Appropriations" include not only "appropriated amounts" but also "funds," "authority to make obligations by contract before appropriations," and also "other authority making amounts available for obligation or expenditure."

Appropriations are not amounts of cash set aside in the Treasury for only some particular use<sup>92</sup>

Thus, when an appropriation expires and the unobligated authority balances of obligation authority are withdrawn, this does not constitute a preservation of an ever-increasing amount of funds set aside by the Treasury to remain idle until needed for restoration. . . .

Some federal agencies -- such as government corporations and "independent establishments" -- are subject only to fiscal restrictions on their use of appropriations (1) that can be directly implied from their enabling legislation, (2) that are included in applicable appropriation acts, or (3) that are made specifically applicable to such agencies.<sup>93</sup>

While it is not possible, in the scope of this paper, to adequately treat all the statutory limitations Congress has imposed on the use of appropriated funds, it is possible to address some of the most important statutory restrictions. In the following discussions of the most basic statutes, it is apparent that the linchpins of the fiscal control scheme are 41 U.S.C. §§ 11 and 12, and 31 U.S.C. §§ 1301, 1341 (a), 1502, and 1517 which restrict contract authority by restraining the use of appropriations to their congressionally-mandated availability in purpose, time and amount. While violations of the fiscal control statutory scheme have occurred, it is worth remarking that these violations seem to be exceptions to a

general pattern of Executive Branch compliance.

Primary Principles

a. 41 U.S.C. § 11: No Contracts Without Authority

§ 11. No contracts or purchases unless authorized or under adequate appropriation

(a) 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 fulfilment, 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.

This law, section 3732, Revised Statutes, states the predicate for the foremost fiscal control limitation: contracts made without authority are void at least to the extent of the absence of authority because government agents acting without express or implied authority cannot not bind the United States.<sup>94</sup>

The purpose of this law is to prevent executive branch agents from involving the government in expenditures and liabilities beyond those authorized by Congress.<sup>95</sup> A contract will not offend this section if it either was expressly or impliedly authorized by law, or was impliedly authorized by an appropriation. If appropriated funds are not involved, a contract will be void as without authority, unless otherwise

authorized by law;<sup>96</sup> and where otherwise authorized, a contract will be valid even though funds appropriated for it are insufficient.<sup>97</sup> But where the authority to contract is founded on the implied authority of a specific appropriation, generally purported liabilities will not bind the government beyond the amount appropriated for that purpose.<sup>98</sup> An agreement by a government agent to reimburse a contractor after Congress provides appropriations directly violates 41 U.S.C. § 11, and will be illegal and unenforceable unless Congress ratifies it.<sup>99</sup>

The express statutory exception for certain DOD contracts -- the "food and forage" provision -- is regarded as a provision of contract authority has been administratively limited to emergency situations.<sup>100</sup>

**b. 31 U.S.C. § 1501: Recording Obligations**

Financial obligations of the United States may only be recorded when certain written evidence is available. Until obligations are recorded, they are not effective to obligate funds in any account, although funds may be administratively committed (or reserved) before the necessary documentary evidence exists to record an obligation.



§ 1501. Documentary evidence requirement for Government obligations

(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;

. . . ;

. . . ;

(4) an order issued under a law authorizing purchases without advertising --

(A) when necessary because of a public exigency;

(B) for perishable subsistence supplies; or

(C) within specific monetary limits;

. . . ;

(6) a liability that may result from pending litigation;

. . . ;

. . . ;

(9) other legal liability of the Government against an available appropriation or fund.

(b) A statement of obligations provided to Congress . . . by an agency shall include only those amounts that are obligations consistent with subsection (a) of this section.<sup>101</sup>

The enforceability of an obligation against the United States does not depend on its prior recording although there may be no authority to make payment until recording occurs. The appropriation to be charged with the obligation will depend on the time the obligation arose, not when it became recordable nor when actual payment was made. Where no "binding agreement" arises within a fiscal year, funds available for obligation that year may not be used.<sup>102</sup>

On the other hand, legal obligations may well arise before the required documentary evidence is available: "The obligation arises simultaneously with the making of the expenditure or the incurrence of the debt. The fact that the recording of the obligation or the payment thereof cannot be made until certain documentary evidence is received is immaterial insofar as determining when the obligation arises and the fiscal year appropriation chargeable therewith."<sup>103</sup> A valid contract which is improperly not recorded remains a valid contractual obligation, while an invalid contract which is recorded does not gain greater status simply because it is recorded as an obligation<sup>104</sup> and, while an oral agreement may not be recorded as an obligation, still a quantum meruit or quantum valebant recovery may be allowed in the Claims Court.<sup>105</sup> However, it seems there is no authority to pay obligations -- at least from time-limited funds -- that were not properly recorded when they arose unless the duty to pay

results from lawsuits or "rights of action involving the right to an amount payable from the balance."<sup>106</sup>

The primary purpose of the recording statute is to provide accurate budgetary information by establishing a standard for obligation recording, although other purposes are also served: preventing overobligation of funds or other Antideficiency Act violations, helping assure that the proper fiscal year's funds are charged, and advising the President and the Congress of outstanding obligations which will likely require funding. To incur a recordable obligation an agency must take action imposing a legal liability on the government which (1) will result in the expenditure of funds, or (2) could mature into a legal liability of the government by virtue of actions by other parties beyond the control of the government.<sup>107</sup> While the Comptroller has permitted flexibility in unusual circumstances involving such matters as the recording of loan guarantees and the obligations of revolving funds,<sup>108</sup> he has objected to recording practices not based on pre-existing enforceable legal obligations where serious congressional misinformation was likely to result because agencies could acquire large unobligated balances.<sup>109</sup>

Circumstances in which the extent of the government's obligation may vary create difficult budgeting problems. Classifying obligations as contingent or indefinite results in

differing duties to record. These differing duties result because sometimes there is substantial doubt as to the amount of financial obligation actually incurred. Some contract clauses necessarily create legal liabilities which are indefinite at the time of contract formation or which are contingent upon the happening of some remote event -- for example Changes, Termination for Convenience and Option for Additional Quantity clauses.<sup>110</sup> To reach an administratively workable rule in these circumstances, the Antideficiency Act has not been applied strictly, but the rule has been that the appropriation current at the time the agreement was formed and the obligation entered into will be chargeable when the amount of the obligation becomes definite.<sup>111</sup> In DOD, an elaborate reporting system has been developed to track and manage obligations.<sup>112</sup>

Indefinite liabilities. The Comptroller has addressed contracts with price redetermination or revision, and variable quantities provisions. The Comptroller accepted DOD's proposal to record only the fixed prices or the target or billing prices (in incentive contracts) stated in the contracts, but DOD agencies were required to administratively reserve funds to cover at least the excess of estimated increases over decreases, and in variable quantity contracts DOD agencies were required to reserve funds sufficient to cover any variations. The amount stated as the maximum

liability in letter contracts and letters of intent are required to be recorded as the amount of the government's obligation. When price revisions were possible, the Comptroller required changing the amount originally recorded to reflect the agreed price revisions.<sup>113</sup>

Agencies have discretion to reserve funds by commitment when they decide their ultimate liability under a contract subject to price variation will exceed the sum obligated, even though the documentary evidence required to record the larger expected obligation is unavailable. "The decision to commit funds is made on a contract by contract basis depending on the likelihood of an overobligation of funds, the amount of money available in the appropriation, and the need for flexibility in administering the appropriation."<sup>114</sup>

Contingent liabilities. When the government will only be liable under a contract if a remote event occurs, the liability is said to be contingent. The prohibitions of the antideficiency laws apply to contingent liabilities, even though no recordable "obligation" in the sense defined in 31 U.S.C. § 1501 has yet occurred.<sup>115</sup> While the Comptroller has disapproved of contractual arrangements which would subject the government to indeterminate liabilities, arrangements which impose liabilities that are limited, or determinable, at

the outset have been approved although the Comptroller has required "funds available" clauses even in these cases. The agreement must provide expressly -- with no implication that any deficiencies will later be cured by further appropriations -- that the government's liability is limited to appropriations available at the time the liability becomes definite, to eliminate the potential for Antideficiency Act violations.<sup>116</sup> With contingent liabilities, no obligation may be recorded until the event actually occurs, and funds need not be committed "unless and until some circumstance arises from which it is apparent that a demand under the clause may be made."<sup>117</sup>

But Professors Nash and Cibinic cite a third, hybrid classification between contingent and indefinite liabilities. Claims denied by contracting officers are contingent liabilities, despite the fact that their decisions may be reversed on appeal, and yet amounts to cover these contingent liabilities are permitted to be administratively reserved, or at least reported as a footnote in statements of financial condition of public enterprise fund accounts to make full disclosure.<sup>118</sup> Yet when DOD's practice of administratively reserving funds to cover contingent cancellation charges under multi-year contracts resulted in the accrual of large unexpended balances, the House Committee on Appropriations instructed DOD not to reserve funds to cover these

contingencies. The Committee viewed the government as a self-insurer as to such contingent expenses.<sup>119</sup>

The government generally is a self-insurer, but the government may not permit its contractors to assume a similar self-insurance risk.<sup>120</sup> Sometimes, though, the government will or must assume insurance risks by indemnifying contractors.

Indemnification agreements are good examples of the Comptroller's treatment of contingent liabilities. When an agency agrees to indemnify another contractual party, the government assumes liability for loss if some remote occurrence should happen and yet it often does not reserve funds to cover such contingent obligations, even though they may subject the government to the risk of potentially large liabilities.<sup>121</sup> In the case of indemnity agreements covering risk of loss to contractor-owned property -- absent some specific statutory indemnification authority -- the Comptroller required either the obligation or administrative reservation of funds to cover the contingent liability, or an express contractual limitation of the government's liability to appropriations available at the time of the loss making it plain that Congress will not be obliged later to cover any deficiencies with appropriations.<sup>122</sup> Generally, with contingent liabilities, funds may not be obligated until a

demand is made, or notice that at least part of the liability has become fixed, and the required documentary evidence (at least in the form of adequate written evidence of an existing obligation) is received. Availability of funds will be determined as of the time the liability becomes fixed, not the time the obligation is recorded.<sup>123</sup> The Comptroller recently summarized his rules on indemnification agreements this way:

The Government may not enter into any indemnification agreement which would impose an indefinite or potentially unlimited liability on the Government, with the exception of the narrowly limited situation in 59 Comp. Gen. 705 [for procuring public utility services]. Since the obligation or administrative reservation of funds is not a feasible option in the indefinite liability situation, the only cure is for the agreement to expressly limit the Government's liability to available appropriations with no implication that Congress will appropriate the money to meet any deficiencies. If the Government's potential liability is limited and determinable, an agreement to indemnify will be acceptable if it is otherwise authorized and if appropriate safeguards are taken to protect against violation of the Antideficiency Act. These safeguards may be either the obligation or administrative reservation of sufficient funds to cover the potential liability, or the inclusion in the agreement of a clause expressly limiting the Government's liability to available appropriations.<sup>124</sup>

Indemnification agreements do arise in government contracts because a substantial, not fully insurable risk of loss to contractor property and to third parties may exist. This risk is sometimes not fully insurable due to policy recovery limits, risk exclusions, or deductibles. Generally, the cost of private insurance protection against such risks is



included in the price paid by the government. Ordinarily, special statutory authority is required to provide indemnification not limited to appropriations available at the time of demand,<sup>125</sup> precisely because the Antideficiency Act prohibits obligating the United States in excess of or before the availability of appropriations, "unless authorized by law." The authority used by procuring agencies to contractually indemnify other parties against losses is provided by various statutes which have been sought by the agencies.<sup>126</sup>

10 U.S.C. § 2354. Applicable to DOD research and development contracts, this statute authorizes indemnification against claims by third persons and loss or damage to the contractor's property arising from direct performance of the contract, resulting from a risk defined in the contract as "unusually hazardous," and not compensated by private insurance, "or otherwise." The contract must permit the government to elect to control or assist in defense against claims, and no amount may be paid unless the department head certifies amounts as "just and reasonable." State substantive and procedural law will be applied to adjudge liability, and indemnity provided is not limited in amount. The act authorizes payment from funds allotted to that contract, funds available for research or development not otherwise obligated, or funds appropriated for such payments specifically.

Indemnity pursuant to Pub. L. No. 85-804 is limited to cases which cannot be indemnified under 10 U.S.C. § 2354.

Pub. L. No. 85-804. Applicable to "any department or agency . . . which exercises functions in connection with the national defense," this law has been used to authorize indemnification limited to available appropriations and unrestricted indemnification against unusually hazardous or nuclear risks, where indemnification will "facilitate the national defense."<sup>127</sup> Pub. L. No. 85-804 requires that this authority may not be used

To obligate the United States in an amount in excess of \$50,000 without approval by an official at or above the level of an Assistant Secretary or his Department or an assistant head or his deputy of such department or agency, or by a Contract Adjustment Board established therein. . . .

To obligate the United States in any amount in excess of \$25,000,000 unless the Committees on Armed Services of the Senate and the House of Representatives have been notified of such proposed obligation and 60 days of continuous session of Congress have expired following the date on which such notice was transmitted to such Committees and neither House of Congress has adopted, within such 60-day period, a resolution disapproving such obligation.

Executive Order 10789, as amended, implements this law and permits indemnification not limited to amounts appropriated if the risk is "unusually hazardous or nuclear" in nature. The executive order would permit the recovery of contractor or third-party claims or losses, including

reasonable expenses of litigation and settlement. Further, DAR 17-205.1 (b)(iv) also excluded indemnification agreements from the \$25 million congressional reporting threshold.<sup>128</sup> This unrestricted authority to indemnify is used to supplement commercially available insurance, not to displace it,<sup>129</sup> where the risks are inherently hazardous or catastrophic, thus preventing determination and insuring against some known extent of liability. Pub. L. No. 85-804 may be affected by the legislative veto provision, invalidated in INS v. Chadha, 454 U.S. 212 (1983).

Price-Anderson amendment to the Atomic Energy Act of 1954.<sup>130</sup> Applicable to the Department of Energy requiring it to indemnify licensees and contractors against liability for a nuclear incidents up to a \$560 million aggregate for all persons indemnified for each incident including "the reasonable costs of investigating and settling claims and defending suits" after they acquire certain amounts of private insurance. The act supplements this private insurance with a "deferred premium" insurance pool to which all licensees would contribute certain amounts in the event of an accident, and government indemnification up to the \$560 million aggregate liability limit. The act is a federal limit on liability recoveries under state laws. This act was intended to overcome the reluctance of contractors to work in an area of risk in which private insurance companies would not provide

reasonably-priced insurance. This indemnification authorization provides that "[i]n administering . . . this section, the [agency] may make contracts in advance of appropriations and incur obligations without regard to sections 1341, 1342, and 1349-1351 and Subchapter II of chapter 13 of Title 31."<sup>131</sup> This law, too, contains a legislative veto provision, invalidated in INS v. Chadha.

Foreign Assistance Act of 1961.<sup>132</sup> This act gives the President power, which he has exercised in Executive Order 11223, 30 Fed. Reg. 6635 (1965), as amended, to execute the functions of the Foreign Assistance Act "without regard to such provisions of law . . . regulating the making, performance, amendment, or modification of contracts and the expenditure of funds of the United States Government as the President may specify."

Veterans Omnibus Health Care Act of 1976.<sup>133</sup> Under this act indemnification may be provided by the Veterans Administration for unusually hazardous risks arising out of direct contract performance, covering "biomedical, prosthetic, and health care services research, . . . stressing research into spinal cord injuries and other diseases that lead to paralysis of the lower extremities." Payment provisions are similar to those for 10 U.S.C. § 2354, and the Administrator is permitted to specify the amount of private insurance the

contractor must carry, while he must also certify any indemnity payment as "just and reasonable." The Administrator is authorized specifically to use the facilities of private insurance companies and to make contracts without advertising as required by Section 3709, Revised Statutes, codified at 41 U.S.C. § 5, and to make advance payments under such insurance contracts.

Pub. L. No. 96-48.<sup>134</sup> This act gives NASA power to provide liability insurance or indemnify a "user of a space vehicle" for third party liability for injuries caused by "activities carried on in connection with the launch, operations or recovery" of space vehicles to the extent the user is not covered by insurance. Such indemnification "may be limited to claims resulting from other than the actual negligence or wilful misconduct of the user." NASA is empowered to place itself in the position of an excess liability insurer. Payments may be made either from unobligated funds available for research and development or from funds specifically appropriated for such payments.

NASA published its Plan for Implementing Space Transportation System [the "Space Shuttle"] Insurance and Indemnification Requirements and proposed rules implementing its plan.<sup>135</sup> Under NASA's plan, the United States will self-insure military and NASA payloads, and small scientific

and research payloads weighing less than 200 pounds with dimensions less than five cubic feet. NASA's contract for launch and associated services is reported to require, under Article V, "Allocation of Certain Risks," that insurance be obtained by other users covering the United States, its contractors, and its subcontractors, as well as the covered users. Policies must allow the United States to settle all claims after consultation with the user and perhaps the insurer, and may exclude coverage of liability to the insured's own employees. Bodily injury and property damage is reportedly handled by requiring a no-fault no-subrogation inter-party waiver of liability, with each party bearing damages it sustains. Third parties, such as contractors and contractors' employees used by users of the Shuttle are also required to agree to this waiver of liability. The requirement to cover the United States under such policies derives in part from the potential United States liability assumed under the 1972 Convention on International Liability for Damage Caused By Space Objects.<sup>136</sup>

Such methods of allocating the risks of injury caused by government procurement activities have been criticized on practical grounds. In particular that 1) they provide no swift, non-judicial, administrative remedy to victims of loss directly against the United States on an absolute liability basis, and 2) they do not adequately protect contractors and

subcontractors because they fail to make such an administrative remedy the exclusive remedy for losses caused by the government procurement activities.<sup>137</sup>

It has been urged that even contingent obligations should be funded:

[T]he executive branch simply refuses to take seriously the [Antideficiency] Act's requirement that adequate funds be currently available for all allocable obligations [as opposed to expenses].

Aside from firm obligations such as the undisputed value of contracts in force, other very significant obligations are those which are disputed in amount, or contingent upon an event such as the exercise of an option, or which will arise only if the government terminates certain contracts, before they have been fully performed. Although the extent of these obligations is not always clear until all disputes have been settled, it is usually undisputed by both parties that some obligations do exist which the government will eventually have to pay.

Even where the obligations are contingent, and so may never become firm requirements that the government expend money, the Act still requires that they be currently funded in order either to permit the government actually to use its judgment when the option must be exercised, if the contingency is a government option, or to prevent sudden overobligations, if the contingency is one which is self-actualizing, such as escalation due to inflation in the market or increased allowable labor rates.<sup>138</sup>

It seems impossible to fund contingent liabilities which by their nature often cannot be predicted precisely, even though they may be "capped" with a "funds available" clause. The present policy adequately serves the underlying

goal of the fiscal control laws, which is to preserve the Congress' right to determine the extent to which the United States may draw funds from the Treasury.

**c. 31 U.S.C. 1532: Transfers of Appropriations**

**§ 1532. Withdrawal and credit**

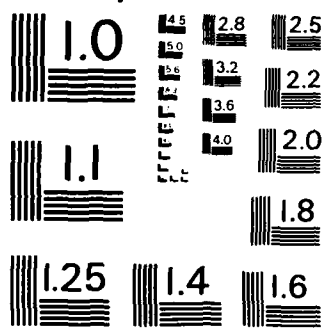
An amount available under law may be withdrawn from one appropriation account and credited to another or to a working fund only when authorized by law. Except as specifically provided by law, an amount authorized to be withdrawn and credited is available for the same purpose and subject to the same limitations provided by the law appropriating the amount.<sup>139</sup>

This law speaks plainly. It bars the transfer of funds between appropriation accounts, except as authorized by law. Occasionally this authority has been implied, not only from the words of the appropriation acts involved, but from the perceived purposes of other legislation.<sup>140</sup>

Congress attempted to force the Executive Branch to respect Congress' policy and program choices by barring transfers between accounts. This was made necessary by the Executive Branch's early practice of ignoring the intent of Congress and transferring sums between accounts established in very detailed, itemized appropriation acts, and thereby defeating the legislature's appropriation object and amount limits.<sup>141</sup>







MICROCOPY RESOLUTION TEST CHART  
NATIONAL BUREAU OF STANDARDS-1963-A

But a great deal of flexibility has been authorized, and this authority has been recognized by the Comptroller. For example, Section 2309, Title 10, United States Code, permits making available for obligation "through administrative allotments" of procurement funds appropriated to the Army, Navy, Air Force, Coast Guard or NASA without transfer on the Treasury's accounts. In DOD, such transactions are defined to create "transfer appropriation accounts" to distinguish them from the regular administrative subdivision of apportionments. Functional reorganizations, both intra-agency and interagency, may also entail authorized funds transfers,<sup>142</sup> and sometimes an agency may properly use its appropriations for the benefit of another agency and treat its repayment obligation as an "account receivable."<sup>143</sup> Agencies may sometimes contract for goods or services to be delivered by other agencies.<sup>144</sup>

Also, "reprogramming" of funds is an informal coordination between agencies and congressional oversight committees which permits shifting of funds between accounts within appropriations to change the purposes for which they are available.<sup>145</sup> Reprogramming might be regarded as a technique permitting reallocation of resources between related programs to accommodate to unforeseen developments, thus funding higher priority requirements at the expense of lower

priority requirements. Naturally, reprogramming is useless where sufficient unobligated funds do not exist within the appropriation, or where they have expired. The Congress through its acquiescence has recognized this need for administrative flexibility, and so has the Comptroller:

[W]e have recognized that, with respect to appropriations, there is a clear distinction between the imposition of statutory restrictions or conditions which are intended to be legally binding and the technique of specifying restrictions or conditions in a nonstatutory context.

In this regard, Congress has recognized that in most instances it is desirable to maintain executive flexibility to shift around funds within a particular lump-sum appropriation account so that agencies can make necessary adjustments for 'unforeseen developments, changing requirements, incorrect price estimates, wage-rate adjustments, changes in the international situation, and legislation enacted subsequently to appropriations.' This is not to say that Congress does not expect that funds will be spent in accordance with budget estimates or in accordance with restrictions detailed in Committee reports. However, in order to preserve spending flexibility, it may choose not to impose these particular restrictions as a matter of law, but rather to leave it to the agencies to 'keep faith' with the Congress. . . . [T]here are practical reasons why agencies can be expected to comply with these Congressional expectations. If an agency finds it desirable or necessary to take advantage of that flexibility by deviating from what Congress had in mind in appropriating particular funds, the agency can be expected to so inform Congress through recognized and accepted practices.

On the other hand, when Congress does not intend to permit agency flexibility, but intends to impose a legally binding restriction on an agency's use of funds, it does so by means of explicit statutory language. . . .

Accordingly, it is our view that when Congress merely appropriates lump-sum amounts without statutorily restricting what can be done with those funds, a clear inference arises that it does not intend to impose legally binding restrictions and indicia in committee reports and other legislative history as to how the funds should be or are expected to be spent do not establish any legal requirements on Federal agencies. . . . 'unless carried into the appropriation act itself.'<sup>146</sup>

The reprogramming thresholds -- the dollar limits beyond which DOD must seek approval of the congressional oversight committees before effecting a reprogramming of funds -- were recently doubled, enlarging DOD's discretion:

Positive changes also occurred as a result of the congressional deliberations on the FY 1982 appropriations bill. The DOD asked the four congressional authorization and appropriations committees to raise the reprogramming thresholds from \$2 to \$10 million for research, development, test and evaluation (RDT&E), and from \$5 to \$25 million for procurement -- a fivefold increase. The two authorization committees agreed to the increase; however, as a result of a compromise reached in the House-Senate conference on the appropriations bill, the reprogramming thresholds have been doubled to \$4 million and \$10 million for RDT&E and procurement, respectively.<sup>147</sup>

In addition to the interservice administrative allotment and reprogramming authorities, it is commonplace for regular and supplemental appropriation acts themselves to expressly provide a ceiling amount for transfers between accounts and for contingency funds,<sup>148</sup> and, in the case of military construction programs which are often funded by specific line-item appropriations, these stated transfer

ceilings constitute the limit on agency discretion to change the purposes to which those funds may be devoted.

To the extent these authorities for administrative flexibility might be abused, they are subject to the criticism that their existence permits the agencies to defeat the concerted will of Congress with, at best, the concurrence of a few committee members. The Comptroller apparently believes sufficient controls on abuse exist, stating that although the agencies are not legally bound by restrictions stated in the legislative history not carried over into the appropriation act itself, still agencies are

by no means free to simply disregard an expression in pertinent committee reports. The realities of the annual appropriation process, as well as nonstatutory arrangements such as reprogramming, provide safeguards against abuse.<sup>149</sup>

### **Restriction to Particular Purposes**

#### **d. 31 U.S.C. § 1301: Purposes**

##### **For Which Funds Available**

#### **§1301. Application**

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

(b) The reappropriation and diversion of the unexpended balance of an appropriation for a purpose other than that for which the appropriation

originally was made shall be construed and accounted for as a new appropriation. The unexpended balance shall be reduced by the amount diverted.

(c) An appropriation in a regular, annual appropriation law may be construed to be permanent or available continuously only if the appropriation --

(1) is for rivers and harbors, lighthouses, public buildings, or the pay of the Navy and Marine Corps; or

(2) expressly provides that it is available after the fiscal year covered by the law in which it appears.

(d) A law may be construed to make an appropriation out of the Treasury or to authorize making a contract for the payment of money in excess of an appropriation only if the law specifically states that an appropriation is made or that such a contract may be made.<sup>150</sup>

Section 1301 (d) clearly states the general rule that budget authority will not be implied: neither explicit contract authority nor the implied contract authority of an appropriation will be considered created by an act of Congress unless specifically stated. A statute will not be construed as making an appropriation unless the intent to appropriate public funds is stated in very clear terms.<sup>151</sup>

Further, once an appropriation has been made, it may only be used for the purposes stated, and no others.<sup>152</sup> But restrictions on availability stated in appropriations acts will be presumed to apply only to that year, unless permanency is clearly stated.<sup>153</sup> Congress generally leaves discretion in the agencies to choose how to accomplish the goals Congress

has approved,

but, of course, administrative discretion may not transcend the statutes, nor be exercised in conflict with law, nor for the accomplishment of purposes unauthorized by the appropriation; and, just as clearly, such unauthorized objectives may legally no more be reached indirectly by stipulations in contracts chargeable to the appropriation than by direct expenditure. . . .

. . . .

. . . Contract stipulations tending to restrict competition and to increase the cost of performance -- and thereby the charges against the contract appropriations -- are unauthorized unless reasonably requisite to the accomplishment of the legislative purposes of the contract appropriation, or unless such stipulations are expressly authorized by statute, and when Congress has legislated on the subject, it is not open to administrative discretion to stipulate contract conditions beyond or at variance with those directed by statute.<sup>154</sup>

If appropriations are not fully used for the intended purposes, generally they may not be used for any other purpose.<sup>155</sup>

Appropriations may not be supplemented from other sources without express authority, otherwise Congress' restriction to a particular program level would be defeated. The appropriations of one agency generally may not be supplemented by funds appropriated for the use of another -- this would be an unlawful "augmentation of appropriations."<sup>156</sup> However, it is not a violation of this section for one agency to reimburse another for supplies or services furnished, so



long as the procurement itself was authorized.<sup>157</sup>

Furthermore, specific appropriations may not be supplemented by general appropriations within the same agency, for much the same reasons, although this is a policy limitation rather than a statutory limitation.<sup>158</sup> Even when a general appropriation would ordinarily be available for a class of purposes including

the purpose of the specific appropriation, the specific appropriation operates as a pro tanto repeal of the general appropriation, rendering its use for the specific purpose illegal.<sup>159</sup>

The purposes for which an appropriation is available will be determined primarily from the words of the acts themselves. Occasionally the intent of Congress in making appropriations may be determined from not only the language, but also the purposes, of other acts. In one case, the Comptroller permitted the pooling of 16 bureaus and offices of the Treasury Department to permit the Treasury Department Legal Division's Executive Development Program to be conducted on an agency-wide basis, to effectuate the purpose of part of the Civil Service Reform Act of 1978.<sup>160</sup>

## Availability Restrictions to Particular Times

### e. 41 U.S.C. § 13: Supply Contracts

#### Limited to One Year

##### §13. Contracts limited to one year

Except as otherwise provided, it shall not be lawful for any of the executive departments to make contracts for stationery or other supplies for a longer term than one year from the time the contract is made.

Although Section 3735, Revised Statutes, sets forth the general rule that none of the executive departments may procure supplies for more than "one year from the time the contract is made,"<sup>161</sup> exemptions have been common.

The General Services Administration (GSA) has been exempted,<sup>162</sup> as have all the armed services and the National Aeronautics and Space Administration (NASA),<sup>163</sup> the performance of functions under the Foreign Assistance Act,<sup>164</sup> and the manufacture of distinctive paper for United States currency and securities.<sup>165</sup> The Secretary of the Treasury has been authorized specifically to "make a contract for a period of not more than 4 years to manufacture distinctive paper,"<sup>166</sup> and DOD components may procure certain supplies and services for up to five year periods<sup>167</sup> and certain energy production facilities for up to 30 year periods,<sup>168</sup> with payment to be made from annual appropriations for the year in which the

goods or services are provided.

**f. 31 U.S.C. § 1502: Duration of  
Funds Availability**

§ 1502. Balances Available

(a) The balance of an appropriation or fund limited for obligation to a definite period is available only for payment of expenses properly incurred during the period of availability or to complete contracts properly made within that period of availability and obligated consistent with section 1501 of this title [specifying when obligations may be recorded]. However, the appropriation or funds is not available for expenditure for a period beyond the the period otherwise authorized by law.

(b) A provision of law requiring that the balance of an appropriation or fund be returned to the general fund of the Treasury at the end of a definite period does not affect the status of lawsuits or rights of action involving the right to an amount payable from the balance.<sup>169</sup>

The purpose of this law is to restrict the use of time-limited appropriations to obligations and expenditures for required goods and services in the particular period for which the the appropriations were made. Appropriations will be presumed to be annual funds available for obligation only during one fiscal year, unless stated otherwise in the appropriation.<sup>170</sup> Claims against such fixed-year appropriations are chargeable to the appropriation for the period in which the original obligation was incurred. Similarly, claims against multiple-year appropriations are chargeable to those appropriations.<sup>171</sup>

In the codification of this new Section 1502, the wording seems to have been broadened, although the meaning may not have been because the codification was expressly to be without substantive change. The predecessor of Section 1502 (a), the former 31 U.S.C. § 712a read:

Except as otherwise provided by law, all balances of appropriations contained in the annual appropriation bills and made specifically for the service of any fiscal year shall only be applied to the payment of expenses properly incurred during that year, or to the fulfillment of contracts properly made within that year.

(Emphasis added). The former Section 712a -- which was one of the statutory underpinnings for the bona fide needs rule -- could be read as applying only to annual (i.e., one-year) appropriations, although the Comptroller did not so read it,<sup>172</sup> while Section 1502 plainly applies to any appropriation or fund that is limited for obligation to any definite period. This is, of course, language which would include multiple-year as well as annual appropriations -- only no-year funds would be excluded. This distinction in the availability of annual and multiple year funds is the basis for multiyear contracting without specific statutory authority using multiple-year procurement funds. If Section 1502 should be held to have been broadened to restrict the use of multiple-year funds as well as annual funds, then multiyear contracting without specific statutory authority could only be accomplished to

serve the needs of years not within the funded period by using no-year funds.

Also, the former Section 712a could be read to permit availability of annual funds to any expenses incurred or to contracts properly made during that fiscal year, Section 1502 seems to require additionally that obligations must have been properly recorded during the period of availability as a condition of making payment from time-limited appropriations. A possible alternative reading might be that only obligations which are ultimately recorded may be paid from funds "limited for obligation to a definite period."

In passing, it may also be worth noting that when the words "[e]xcept as otherwise provided by law" were eliminated as unnecessary, an apparent conflict with some other laws which expressly allow time-limited funds available in subsequent years to be obligated to satisfy multi-year obligations created in earlier years. For example, 10 U.S.C. § 2675 (a) permits leases up to five years (with successive five-year options implicitly permitted), and authorizes each yearly rental to be paid from funds appropriated to that military department for that year. Such conflicting laws should be seen as statutory exceptions to the general rule on availability of 31 U.S.C. § 1502.

Generally, the appropriation current when a contract is formed will be charged for payment, whether performance is fully rendered within that fiscal year or not, as will cost increases and the cost of substitute performance contracts.<sup>173</sup>

The appropriation originally charged remains available even after its period of availability to fund substitute performance if a valid obligation was originally created to satisfy a then-current bona fide need and a current bona fide need for the goods or services continues to exist at the time of the substitute award.<sup>174</sup> This rule has been followed even where the original contract award was erroneously made,<sup>175</sup> but the rule is to the contrary where there was a failure to form a valid obligation during the period of availability.<sup>176</sup> An unreasonable delay in terminating the original contract or in procuring substitute performance will preclude use of the original appropriation.<sup>177</sup>

The Comptroller recently summarized his rules governing funding replacement contracts:

A. The original funds remain obligated and available for funding a replacement contract, regardless of the year in which the replacement contract is awarded:

(1) Where the contracting officer terminates an existing contract for default on the part of the contractor, and the determination that the contractor defaulted has not been overturned by a Board of Contract Appeals or a Court; or

(2) Where a replacement contract has already been awarded, after an agency terminates for default, by the time a competent administrative or judicial authority converts the default termination to a termination for convenience of the Government.

In both situations, the replacement contract must satisfy certain general criteria to be considered a replacement, as opposed to a new, contract. First, it must be made without undue delay after the original contract is terminated. Second, its purpose must be to fulfill a bona fide need that has continued from the original contract. Finally, it must be awarded on the same basis and be substantially similar in scope and size as the original contract.

B. The original funding obligation is extinguished upon termination of the contract and the funds will not remain available to funds a replacement contract:

(1) Where the contracting officer terminates an existing contract for the convenience of the Government, either on his own initiative or upon the recommendation of the General Accounting Office; or

(2) Where the contracting officer has terminated an existing contract for default and has not executed a replacement contract on the date that a competent administrative or judicial authority orders the conversion of the original termination for default to a termination for convenience of the Government.

In these situations, the original obligation must be deobligated to the extent it exceeds termination costs. Any subsequent contract awarded must be regarded as a new contract chargeable to appropriations current at the time of the new award.

C. [Despite a defaulted contractor's appeal, replacement contracts remain charged to the original funds], regardless of the eventual outcome of [the original contractor's] appeal.<sup>178</sup>

Increased costs may result from many causes, including changes in requirements, delay and increased overhead. When the government's liability -- if any -- to pay for such increased costs arises from the terms of the original contract and is within the contract's scope, the appropriation initially used to fund the contract must be used.<sup>179</sup> Additional payments incurred under the original contract may be charged to the annual or multiple-year funds originally obligated on the theory that such additional charges do not create new obligations:

[T]he obligations and liabilities of the parties respecting such changes are fixed by the terms of the original contract, and the various amendments merely render definite and liquidated the extent of the Government's liability in connection with such charges.<sup>180</sup>

This is called the "relation back doctrine." The general rule is that an appropriation's availability period relates to the authority to obligate the appropriation, but apparently some contract provision under which the contractor is entitled to payment as an antecedent legal right is required before it can be used, unlike wholly discretionary grant amendments which must be accomplished during the period of availability of time-limited funds to successfully obligate those funds.<sup>181</sup>

To be chargeable to the original appropriation, increased costs attributable to changes must be within the



scope of the Changes clause -- cardinal changes are new procurements and must be charged to the appropriation current when the change is issued.<sup>182</sup> Where a contract is cancelled by mutual agreement and the identical goods or services are later sought, the "replacement" in another fiscal year cannot be charged to the original appropriation because it is not made against the account of a defaulted contractor but rather is chargeable to the United States.<sup>183</sup>

Cost overruns, too, should be charged to the appropriation available in the year the contract was made. Current appropriations may not be used to fund overrun costs unless they amount to new liabilities not provided for under the original contract. Where a contractor is entitled to a price adjustment under the original contracts' terms only the original appropriation charged is available to fund the cost overrun. Further, where either of several appropriations originally could have been selected to fund a contract, the Comptroller has held the agency will remain bound by its election to "continued use of the same appropriation to the exclusion of any other for the same purpose."<sup>184</sup>

The general rule is that funds received for the use of the United States must be deposited into the Treasury as miscellaneous receipts.<sup>185</sup> Repayments to appropriations are classed as reimbursements and refunds. Reimbursements would

augment appropriations if credited to them, since a reimbursement is payment for goods or services furnished. Without specific authority to retain reimbursements, they must be deposited to the Treasury. As to refunds, money received by the government as a consequence of previous obligations, generally, losses or damages recovered by set-off or otherwise attributable to contractor failure to perform will not be credited to the appropriation originally charged -- instead they will be paid into the Treasury as miscellaneous receipts,<sup>186</sup> unless the excess procurement costs credit "represented payments in excess of the value of the work performed . . . on the principle that the appropriation had been erroneously charged therewith in the first instance."<sup>187</sup> Liquidated damages recoveries may be retained by the agencies and credited to the original appropriations where they may be needed to repay the contractor should he be relieved on appeal of liability for the delay -- but they must be committed to pay the contingent liability until recovered into the Treasury with the lapsed appropriations (if time-limited), or until a reasonable time elapses after which they may be considered part of the remaining unobligated balances (if no-year funds).<sup>188</sup>

**g. 31 U.S.C. § 3324: No Advance Payments  
Without Specific Authority**

**§ 3324. Advances**

(a) Except as provided in this section, a payment under a contract to provide a service or deliver an article for the United States Government may not be more than the value of the service already provided or the article already delivered.

(b) An advance of public money may be made only if it is authorized by --

(1) a specific appropriation or other law;  
or

(2) the President to be made to --

(A) a disbursing official if the President decides the advance is necessary to carry out --

(i) the duties of the official promptly and faithfully; and

(ii) an obligation of the Government; or

(B) an individual serving in the armed forces at a distant station if the President decides the advance is necessary to disburse regularly pay and allowances.

. . . .

(d) The head of an agency may pay in advance from appropriations available for the purpose --

(1) to the Secretary of the Army, charges for messages sent by the Secretary of the Army for the head of the agency, including charges for --

(A) payment of tolls of commercial carrier;

(B) leasing facilities for sending messages; and

(C) installing and maintaining facilities for sending messages; and

(2) charges for a publication printed or recorded in any way for the auditory or visual use of the agency.<sup>189</sup>

The thrust of this statutory general prohibition against advance payments is that the government will only pay for goods or services it has already received. Exceptions are provided, for (1) specific statutory authority provided either in appropriation acts or permanent law, such as Section 3324 (d), or (2) some degree of executive discretion.

It was early held that the President was not required to personally authorize every advance payment, and that he may authorize advances to be paid by regulations within the area left for his discretion.<sup>190</sup> Limited statutory authority to make advance payments has also been granted, but the Comptroller has called these "financing tools" to be used only in limited circumstances.<sup>191</sup>

The Attorney General decided that not only did the statute prevent advance payments, but it also prevented otherwise lawful contracts which purported to require advance payments.<sup>192</sup> Progress payments, however, may be made if the United States has gotten something for its money, such as title or a lien on goods. The Comptroller held that this prohibition "was not intended to prevent a partial payment in

any case in which the amount of the payment had actually been earned by the contractor and the United States had received an equivalent therefor."<sup>193</sup>

This law may be violated in surprising ways. In one case, the Comptroller decided that although the installation costs of telephone equipment were expenses that could properly be incurred and paid from the annual appropriations for that year, where the bidder unbalanced his bid by including the equipment's capital cost in with the installation costs, the contracting officer's acceptance of the bid would be an unlawful advance payment because this amount would be far above the reasonable value of the installation service performed.<sup>194</sup>

Advance payments may also offend the Antideficiency Act as well as the bona fide needs rule when time-limited funds are used to secure goods or services to satisfy the needs of future fiscal years. This was the case when nitrogen gas cylinders purportedly were rented for a 25-year period with the full rental price to be paid in the first year using annual funds. The Comptroller pointed out that the same object could be achieved with an option contract.<sup>195</sup> There would be significantly different contractual consequences, however. The price presumably would be higher to include the risk that the government might choose not to exercise some of

the annual options, the cost would have to be charged to funds current for the years in which the options were exercised, and each year's option quantity should reflect no more than that year's bona fide needs.

The prohibition against advance payments has not been applied to payments for noncommercial services furnished by state or local governments,<sup>196</sup> or the federal government.<sup>197</sup>

#### **Availability Restriction to Particular Amounts**

#### **h. 41 U.S.C. § 12: Restriction to Amounts Specifically Appropriated for Public Buildings or Public Improvements**

##### **§ 12. No contract to exceed appropriation**

No contract shall be entered into for the erection, repair or furnishing of any public building, or for any public improvement which shall bind the Government to pay a larger sum of money than the amount in the Treasury appropriated for the specific purpose.

Section 3733, Revised Statutes, has been interpreted as stating a rule prohibiting construction of public buildings or improvements without "specific prior appropriations."<sup>198</sup> Here, however, "specific appropriation" seems to connote only some approving reference in an appropriation act or even in its legislative history.<sup>199</sup> Apparently any structure in the

form of a building is a "public building" or "public improvement" unless it is clearly temporary. But "[t]he mere fact that the buildings are prefabricated, movable, and accounted for as personal property . . . is immaterial as to whether they are public buildings or public improvements within the contemplation of Section 3733, Revised Statutes."<sup>200</sup>

The management of military construction poses special problems.<sup>201</sup> The military departments have authority under a number of statutes to engage in military construction projects without prior specific statutory authorization. Emergency construction, to a maximum obligational level of \$30 million in any fiscal year, may be accomplished under 10 U.S.C. § 2803 if the agency head certifies the project is vital to national security and the need is "so urgent that deferral until after the next Military Construction Authorization Act would be inconsistent with national security." Under 10 U.S.C. § 2804, "contingency construction" projects not previously authorized may be undertaken if the Secretary of Defense determines that delay until the next construction authorization act "would be inconsistent with national security or national interest." Unspecified minor construction projects may be begun under the authority of 10 U.S.C. § 2805, using only funds authorized for such projects except that operations and maintenance funds may currently be used for projects costing no more than \$200,000.

This act specifies a "maximum amount" used both as a ceiling and as a trigger for varying levels of administrative preauthorization. The maximum amount was initially set at \$1 million and will be subject to adjustment annually in the Military Construction Authorization Act.<sup>202</sup> All these statutes contain legislation veto provisions.

Closely associated is a rule of public policy that appropriated funds may not ordinarily be used to make permanent improvements to private property unless specifically authorized by law.<sup>203</sup> For example, the Economy Act specifically provides that appropriations may be obligated or expended to the extent of 25 per cent of the first year's rent for alterations, improvements, or repairs of rented premises.<sup>204</sup> Limited exceptions to this rule have been recognized in special circumstances because this rule is seen as a policy limitation rather than a legal one.<sup>205</sup> The Comptroller has stated he will not object if appropriations are otherwise available for such improvements and the improvements are determined (1) to be incident to and essential for the effective accomplishment of authorized purposes of the appropriations, (2) primarily for the benefit of the government, and (3) requiring expenses only in reasonable amounts, so long as the contract protects the government's interest in any residual value the improvements might have at the end of the lease term.<sup>206</sup>



**i. The Antideficiency Act: Amount and Timing  
Of Funds Availability**

The Antideficiency Act, formerly codified at 31 U.S.C. § 665, now has been codified in different sections of various titles. Three sections of Title 31, United States Code, form the backbone of the antideficiency laws:

§ 1341. Limitations on expending and obligating amounts

(a)(1) An officer or employee of the United States 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.<sup>207</sup>

§ 1517. Prohibited obligation and expenditures

(a) An officer or employee of the United States Government . . . may not make or authorize an expenditure or obligation exceeding --

(1) an apportionment; or

(2) the time permitted by regulation prescribed under section 1514 (a) of this title [requiring an administrative system to control apportionments].<sup>208</sup>

§ 1342. Limitation on voluntary services

An officer or employee of the United States Government . . . may not accept voluntary services exceeding that authorized by law except for emergencies involving the safety of human life or the protection of property.<sup>209</sup>

The general thrust of the Antideficiency Act is that government agents acting only under the implied contract authority of an appropriation have no authority to either spend or obligate, or to authorize spending or obligation of, public funds without having beforehand enough funds available to pay. Interpreting the words "any contract or other obligation" in the former 31 U.S.C. § 665 (a), the Comptroller stated the belief that they encompassed "not merely recorded obligations but other actions which give rise to Government liability and will ultimately require the expenditure of appropriated funds."<sup>210</sup>

Since contracts that violate the Antideficiency act are illegal at least to the extent of the violation -- leaving aside for the moment questions concerning the legal effect of later congressional ratification of contracts wholly or partly tainted by violations of fiscal control laws -- it has been argued that contractors also have a stake in avoiding violations because they

may result in void contracts, performance by contractors for which they will not be paid, and potential requirements to repay to the government monies which were seemingly properly earned for performance. It is clear, then, that government

contractors may not safely assume the past naive position that the government is 'good' for its debts and that performance will in all events be followed by payment.<sup>211</sup>

The Act was a congressional response to its frustration with the Executive Branch's early acts of disregard for Congress' power to control the obligation of the public treasury.

The Anti-deficiency Act was born of Congressional frustration at the constant parade of deficiency requests for appropriation it was receiving in the 19th century and early 20th century, generated, it believed, by the lack of foresight and careful husbanding of funds by Executive branch agencies. (See Annals of Congress, 10th Cong., 2d Sess., 1809). A consistent theme runs through the myriad pages of floor debates and reports on supplemental appropriation bills: The Congress was tired of receiving appropriation requests which it could not, in good conscience, refuse because the agency had legally or morally committed the United States to make good on a promise. We term such commitment 'coercive deficiencies' because the Congress has little choice but to appropriate the funds.<sup>212</sup>

The basic prohibition was enacted in 1870, and amended seven times.<sup>213</sup> A previous act had prohibited the pooling of current appropriations, and the diversion of old appropriations to new, unintended purposes.<sup>214</sup> The Antideficiency Act was another congressional effort to recover its power of fiscal control primarily by prohibiting the creation of obligations without prior appropriations, called "coercive deficiencies" because Congress was thereby "coerced" into enacting deficiency appropriations to avoid denying

payment to presumably innocent contractors who had already performed.

In the Antideficiency Act, penalties are prescribed only for violations of 31 U.S.C. §§ 1341 (a), 1342 or 1517 (a), ranging from "appropriate administrative discipline including, when circumstances warrant, suspension from duty without pay or removal from office" to criminal penalties of fines as great as \$5,000 or imprisonment for as long as 2 years, or both.<sup>215</sup>

It should be apparent that this law is violated when appropriated funds are obligated beyond their availability in either time, purpose or amount.<sup>216</sup> It should be equally apparent that the antideficiency laws are simply not at issue when Congress has created budget authority in the form of express statutory contract authority, rather than budget authority in the form of the implied contract authority of an appropriation of funds.<sup>217</sup>

Section 1341 (a) contains several distinct prohibitions:

(1) making an obligation or an expenditure in excess of funds currently available for that purpose in the particular appropriation used;

(2) authorizing an obligation or expenditure in excess of funds currently available for that purpose in the appropriation used -- thus a violation could occur even though no excessive obligation or expenditure actually occurred;

(3) doing these same acts before an appropriation is made, that is, before an expected appropriation is enacted.

In the same way, the prohibitions of 31 U.S.C. § 1517 operate to render illegal transactions in excess of or before availability of apportionments.

These laws and their regulatory implementations limit a contracting officer's authority to contract: He may not make award before funds become available if there any possibility that funds might be expended or obligated before they become available, although contracts expressly conditioned or made contingent upon the future availability of funds have been approved.<sup>218</sup>

In the Department of Defense, DOD Directive 7200.1 (1978), "Administrative Control of Appropriations," implements 31 U.S.C §§ 1341, 1342 and 1517. Section 1517 deals not with appropriations, but with apportionments or reapportionments, and prohibits overobligation or overexpenditure at the apportionment level, in effect leaving it to the discretion of

the agency head whether overexpenditures or overobligations of further administrative subdivisions of funds will constitute as antideficiency law violations.<sup>219</sup> DOD Handbook 7220.9-H (1972), "Accounting Guidance Handbook," at paragraph 21003.B.1, stated

[c]reating an obligation or making an expenditure in excess of the amount permitted by DOD Directive 7200.1, or violation of any provisions thereof, is as much, and as serious, a violation of the law as creating an obligation or making an expenditure in excess of an appropriation, apportionment, or reapportionment. . . .

This language certainly lends color to the argument that the authority of contracting officers is limited by this regulatory implementation to the available amount of particular allotments although the United States has frequently argued that its authority to contract is limited only by the "lump sum" of the available appropriation.<sup>220</sup>

Violations of the Act must be reported to the President, through OMB, and to the Congress.<sup>221</sup>

The limitation of 31 U.S.C. § 1342 on the acceptance of voluntary services has been applied against even those who are neither officers nor employees by the Comptroller General who decided that no one may make himself a voluntary creditor of the United States by assuming obligations of the Government without legal authority or compulsion -- prohibiting both the

offer and the acceptance of voluntary services.<sup>222</sup> The Government bears no legal or moral obligation to pay for services rendered in violation of the Act.<sup>223</sup> At least three exceptions are recognized: (1) emergencies involving safety of human life or the protection of government property,<sup>224</sup> (2) express legislative authority to accept voluntary services,<sup>225</sup> and (3) acceptance of voluntary services under the authority of some "provision of law authorizing the acceptance of services without compensation."<sup>226</sup> The Comptroller distinguishes between "gratuitous" and "voluntary" services: gratuitous services, rendered without any expectation of payment, may be accepted.<sup>227</sup> A statutory exception exists permitting the acceptance of voluntary services to be provided for a museum or a family support program. Such volunteers are considered employees for purposes of compensation for work-related injuries and tort claims.<sup>228</sup>

In addition to these punitive sections, the Antideficiency Act required an administrative system of appropriations apportionment to prevent the creation of coercive deficiencies which would result in demands for supplemental or deficiency appropriations, and to prevent interruption of government services through careless administration of funds.<sup>229</sup> Interestingly, however, the Act provides a "safety valve" permitting officials to make and the heads of executive agencies to request apportionments or

reapportionments which would result in supplemental or deficiency appropriation requests, if required by "law enacted after submission to the Congress of the estimates for an appropriation that requires expenditure beyond administrative control," or by "an emergency involving the safety of human life, the protection of property, or the immediate welfare of individuals when an appropriation that would allow the United States Government to pay, or contribute to, amounts required to be paid to individuals in specific amounts fixed by law or under formulas prescribed by law is insufficient."<sup>230</sup>

Under 31 U.S.C. § 1514, agencies must establish administrative controls to restrict obligations or expenditures from each appropriation to the amount of apportionments or reapportionments available and to permit the agency to fix responsibility in the event of a violation.

Implementing these requirements of the Act, apportionments are made initially by OMB, in accordance with its Circular A-34.<sup>231</sup> In the Department of Defense DOD Directive 7200.1 (1978) establishes two more levels of funds division, called allocation and allotment. Allocations of apportionments are made by the Assistant Secretary of Defense (Comptroller) (ASD(C)) to the Secretaries of the military departments who make further allocations to the heads of operating agencies, limited by the amounts OMB has specified



as available for specific uses in each apportionment period. The heads of the operating agencies then suballocate these amounts to subordinate commanders, Major Commanders or Special Operating Agencies. An allotment is a distribution by these commanders to themselves, to installation commanders or other subordinate organizations. This process may continue into as many suballotments as necessary.<sup>232</sup> Each buying activity estimates amounts needed for particular purchases, and an accounting reservation -- called a commitment -- of budget authority is made. Obligation refers to the formation of a valid debt to ultimately expend funds. Actual payments -- outlays or expenditures -- generally take place when disbursing officers deliver checks to contractors or employees for goods or services rendered. Overspending or overobligation at the lowest level violates the Antideficiency Act,<sup>233</sup> and must be reported to the agency head, who is directed to take "appropriate disciplinary action, including, when circumstances warrant, suspension from duty without pay, removal from office where applicable, or appropriate action under the Uniform Code of Military Justice."<sup>234</sup> The DOD Directive requires further implementing regulations in each of the military departments. In the Air Force, this is accomplished in Air Force Regulation (AFR) 177-16 (1980).

Having sketched out the antideficiency laws and some of their implications, the "ultimate questions" seem to be:

What is the legal effect of violating these laws, that is, does a violative contract become void ab initio and therefore unenforceable in its entirety against both parties or perhaps only against the government, or will it be rendered unenforceable only as to the unauthorized, illegal portion -- and, to the extent of the antideficiency law violation, will the affected contractor be able to recover damages for breach of contract (including anticipated profit) or at least the reasonable value of any benefit received by the government under a quantum meruit or quantum valebant theory?<sup>235</sup> The Comptroller has suggested that the exhaustion of funds subsequent to the formation of a valid contract affects neither the government's payment obligations nor the continuing validity of the contract.<sup>236</sup>

Another view of the effect of an antideficiency violation is that, as a matter of law, the entire contract -- which might have been quite legal and enforceable prior to the occurrence of the violation -- suddenly becomes void ab initio, which is to say the former contract has suddenly become a total nullity and therefore completely unenforceable. Oddly, the chief published proponents of this view have also urged that the only proper remedy for an antideficiency violation is a termination for convenience: "Undoubtedly termination for convenience is a legal and appropriate remedy. In fact, it is the only legal remedy available."<sup>237</sup> It seems

apparent, though, that this remedy could only be available under the contract, and always would be unavailable if all contracts suffering from some taint of an antideficiency law violation were always thought totally void ab initio.<sup>238</sup>

In fact, the law seems to have evolved differently, distinguishing in effect between cases in which the contractors had prior notice of the potential unavailability of funds<sup>239</sup> and those in which the contractors did not have actual or constructive notice.<sup>240</sup> Where a contractor is on notice of funds limitation, the courts seem determined to force him at least to share responsibility for taking care not to breach the limits imposed by the known finite amount of funds available. This seems only fair: such notice should render funding limits a boundary of good faith performance which the contractor willingly breaches at his own risk.

It is true that in Hooe v. United States, the Court declared that

[i]f an officer, upon his own responsibility, and without the authority of Congress, assumes to bind the government, by express or implied contract, to pay a sum in excess of that limited by Congress for the purposes of such a contract, the contract is a nullity, as far as the government is concerned, and no legal obligation arises upon its part to meet its provisions.<sup>241</sup>

But it should be clear that the Court was speaking only of the amount promised by the contract which exceeded that amount appropriated, since up to that amount the Secretary of the Interior had implied contract authority supplied by the appropriation. It was only the unappropriated excess portion of the contract which was declared a nullity. Indeed, the lessor was paid the full amount appropriated.

This interpretation is consonant with the reasoning and result in Sutton v. United States.<sup>242</sup> There it was only the unauthorized excess over the specific appropriation amount paid that was permitted to be recouped from an amount owing the same contractor on an entirely separate contract. In fact, he was paid the amount appropriated for that dredging project, and the costs of the faulty supervision by the government which caused the overpayment were not permitted to reduce the appropriated amount available to pay the victimized contractor, although absent government fault such costs clearly would have been chargeable to that account.

Leiter v. United States<sup>243</sup> is also consistent with this interpretation. Leiter involved the purported obligation of annual funds to secure four multiple-year leases, contingent upon appropriations being made available to pay subsequent year's rentals. After the first year's occupancy, but before any appropriation had been made, the government cancelled the

leases and vacated. Sufficient appropriations were in fact made available for the subsequent year. The lessor sued for what seemed a palpable breach of contract, but the Court held to the contrary that the government was bound only to the first year's term -- thereafter, the government would only be bound if its agent agreed to be bound by some affirmative act exercising the implied contract authority of each new fiscal year's annual appropriations as they became available. In essence, the Court found, consistent with prior practice, that the lease created options to continue each year during the term of the lease but that the government would not be bound until an authorized agent affirmatively exercised that authority either with a specific agreement or by continued occupancy, and then only to the limit of the authority afforded by each new fiscal year's annual appropriation -- for one more fiscal year, and no more. Unloubtedly, the contractor's expectations were laid waste by this ruling. At the time of contracting, despite the Court of Claims earlier holdings in similar cases, the lessor may have thought he had an enforceable right to a multiple-year stream of income at a fixed rate. Instead, he found himself bound to be prepared to perform although the government was not bound. He was compelled to await the government's decision each year whether to exercise its fixed rate option to renew for another term. It seems reasonable to suppose that he might have tried to bargain for a higher price had he been aware of this added

risk -- and that difference in price is the measure of what he lost by this decision. It is disturbing that the Court remade the agreement of the parties,<sup>244</sup> but a contractor deals with a government agent outside the scope of his authority at his own risk, certainly when the contractor has notice of the authority limits imposed by the limitations of appropriations available, in this case the dedication of one-year funds to needs of the fiscal year for which appropriated.

There is some room for contractor recovery, though, when there is no notice, either actual or constructive. In Anthony Miller, Inc. v. United States,<sup>245</sup> the Court of Claims even permitted some recovery of the unauthorized excess obligation over the specific limitation permitted by the Capehart Act. While the court stated it would refuse to permit recovery for "simple extras" which pushed the amount owing over the limit established by the maximum amount of the insured mortgage, apparently largely because the contractor was on notice of the ceiling amount and the cost of the work that had already been done, still it permitted recovery for unauthorized obligations that the court thought were beyond the control of the contractor:

To hold otherwise, would open the door to evasion of the statutory limit by collusive action of the contracting officer and the cooperation of a willing contractor. . . .

To be contrasted with simple extras are claims that arise because of work that is necessitated by the government's defective plans or specifications, and claims that fall within the terms of the Changed Conditions clause of the contract. As long as the additional work is required as a result of either of these situations, it is our opinion that the contractor is entitled to recover, even though the result is to increase the cost of the contract above the amount of the insured mortgage [which was the authority limit stated in the Capehart Act].

A somewhat more difficult [intermediate] situation arises when the claim results from ambiguous specifications and the insistence of the contracting officer upon the installation of a more expensive item than the contractor believes to be required by the specifications. Since this is potentially an area for abuse, the contractor's compliance should be made under protest. If that is done, the contractor would be entitled to recover without regard to the mortgage insurance limitation, unless it is shown that the contracting office has, in bad faith, ordered the installation of more elaborate and expensive item than is specified in the contract and that fact is known to the contractor.<sup>246</sup>

The holding in Ross Construction<sup>247</sup> is also consistent, and seems wise.

The duty to pay later for any constructive changes due perhaps to ambiguous specifications, or for some additional costs due to differing site conditions, delay, or to various other causes, is incurred by the government at the time of contract formation. The final, liquidated amount of such contingent liabilities cannot be forecast accurately. To argue that contracts that exceed the amounts allotted to them for such reasons automatically become illegal and void ab

initio is clearly unworkable because, practically speaking, such costs are beyond the control of all the parties. Such costs should continue to be considered contingent liabilities until their amounts become known.

Thus, it appears that government contractors will only be held to this duty to share responsibility for avoiding antideficiency law violations when put on actual or constructive notice of funding limitations. Interestingly, it has been suggested that when a general appropriation is used, actual notice of funds limitation may be achieved by (1) telling the contractor that available funds have been exhausted, (2) using a Limitation of Cost clause in a cost-plus contract, (3) using a Limitation of Funds clause in a multi-year contract, or an incrementally-funded contract. Constructive notice might be achieved by the standard practice of including a citation to the appropriation accounts from which funds will be drawn.<sup>248</sup>

To summarize, contractors are held to know the status and amount of "specific appropriations" funding their contracts. That amount will be a ceiling on contractor recovery in the event an overobligation of that appropriation occurs, and excess obligations over availability will not be recognized as binding the United States, since such contracts are illegal to that extent.<sup>249</sup> However, this is not the case



with contracts funded from "general appropriations," because a contractor "cannot justly be expected to keep track of appropriations where he is but one of several being paid from the fund."<sup>250</sup> So long as the overobligation of a general appropriation occurs without the contractor's fault or knowledge, the contract remains enforceable in the Court of Claims despite the violation, as the court held in Ross Construction Company, to avoid turning the contractor into the helpless victim of the agency's fault or unexpected external conditions.<sup>251</sup>

The rules are quite different when express statutory contract authority has been used. Congressional action to restrict the use of current appropriations to satisfy obligations validly created under existing statutory contract authority does not implicitly repeal the contract authority.<sup>252</sup> Where the government has formed a valid obligation under statutory contract authority, it has been held that the mere failure of Congress to appropriate sufficient funds "does not repudiate the obligation; it merely bars the accounting agents of the Government from disbursing funds and forces the [contractor] to recovery in the Court of Claims."<sup>253</sup> In such a case, the agency would be compelled to seek deficiency appropriations, as it must when obligation adjustments arising under their contracts cause account obligational levels to exceed available appropriations.

"Deficiency appropriations are commonly enacted to rectify poor guesses or meet unanticipated developments."<sup>254</sup> This is the same result that has occurred in the general appropriation without notice cases and in those rare cases in which judgment has been granted under a quantum meruit or a quantum valebant theory despite the illegality of the underlying contract.

Contractors who perform under contracts that violate the Antideficiency Act may be able to recover on a quantum meruit or quantum valebant basis for the reasonable value of what has been furnished under the contract. Although the Comptroller permits such recovery -- at least to the extent of benefits received by the government -- when contractors have performed under contracts void ab initio because formed by agents totally without authority,<sup>255</sup> apparently such a recovery has been permitted very rarely where the contract was formed before funds were available.<sup>256</sup> The general rule seems to be that where the contractor has assumed the risk that insufficient funds will later be provided by performing despite notice of funds limitations he may not be paid more than the amount actually appropriated.<sup>257</sup>

Prior to the Contract Disputes Act of 1978,<sup>258</sup> Claims Court judgments in contracts cases were generally paid from either specific appropriations or from permanent indefinite funds made available for judgments, and not from the

appropriations which the underlying contract originally charged.<sup>259</sup> Under the Contract Disputes Act, § 612 (c), it is provided that both judgments and board of contract appeals awards "shall be reimbursed to the [now-used indefinite judgment fund of 31 U.S.C § 1304 (a)] by the agency whose appropriations were used for the contract out of available funds or by obtaining additional appropriations for this purpose."

There has been sharp criticism of agencies' practices of exercising its transfer and reprogramming authority to "cure" overobligations of specific accounts, or of exercising their discretion to partially or completely terminate contracts for convenience to accomplish the same end, as well as of the practice of seeking supplemental or deficiency appropriations to ratify contracts entered into without the authority provided either by express contract authority or the implied contract authority of an adequate appropriation.<sup>260</sup>

Generally, the criticisms have been (1) that contractors have been asked to continue performance after appropriations have proven insufficient (and in effect to finance at their own expense sometimes large government programs) in the expectation that Congress will provide funds, thus arguably violating the prohibition of Section 3142 against accepting volunteer services;<sup>261</sup> (2) that decisions on

contractors' justified claims have sometimes been delayed for unreasonable periods because appropriations have been unavailable to satisfy them because "to recognize them would turn a 'someday' debt into a current debt for which no funds are currently available";<sup>262</sup> (3) that revolving funds funded with annual funds are being used for other than the 'bona fide' needs of their assigned fiscal years;<sup>263</sup> and (4) most seriously, that these practices have promoted all the fiscal control evils at which the antideficiency laws have been aimed: preventing the Congress from enforcing its policy choices and permitting the Executive Branch to procure goods and services its agencies find desirable despite the lack of prior congressional approval.<sup>264</sup>

It should be noted, however, that it has been judicially suggested that agencies have a "duty to remedy any shortfall that might exist in a particular project account [by reprogramming or seeking reapportionment or a supplemental appropriation]."<sup>265</sup>

If contracts are held ultimately to be completely or partly illegal because of an antideficiency law violation, the question naturally arises: To what extent may contracts, which have become at least partly unenforceable against the government, be ratified by later congressional action by supplying authority via supplemental or deficiency

appropriations to enable performance or to supply funds needed for their termination?

It has been argued that

ratification is probably not possible. Ratification by implication is certainly not possible. Finally, ratification is never possible against an unwilling party [citing 2 Williston, Contracts § 278A (1959)]. . . . Thus, when a contractor is informed that his contract is deficiently funded, he can prevent later 'ratification' by immediately treating his contract as breached, and stopping all work permanently.<sup>266</sup>

The term ratification by implication is used because

Congress as a whole does not state that it wishes to disregard certain violations of law and ratify certain contracts; rather, it simply appropriates money to cover coercive deficiencies. The government then assumes that the appropriation of money for deficiency purposes constitutes a ratification.<sup>267</sup>

It is generally held that ratification by appropriation will not be found unless it can be demonstrated the Congress had prior knowledge of the specific disputed action and the appropriation plainly shows a purpose to ratify the illegal agency action.<sup>268</sup> Appropriations acts often contain this language in their General Provisions:

All obligations incurred in anticipation of the appropriations and authority provided in this Act are hereby ratified and confirmed if otherwise in accordance with the provisions of this Act.<sup>269</sup>

However, this provision seems designed to ratify obligations entered into pursuant to any antecedent continuing appropriations resolution, rather than overobligations of the preceding year's budget authority. Of such general ratifying provisions, the Attorney General has stated:

If legal authority exists for an agency to incur obligations during periods of lapsed appropriations, Congress would not need to confirm or ratify such obligations. Ratification is not necessary to protect private parties who deal with the Government. So long as Congress has waived sovereign immunity with respect to damage claims in contract, 28 U.S.C. §§ 1346, 1491, the apparent authority alone of government officers to incur agency obligations would likely be sufficient to create obligations that private parties could enforce in court. The effect of the ratifying provisions seems thus to be limited to providing legal authority where there was none before, implying Congress' understanding that agencies are not otherwise empowered to incur obligations in advance of appropriations.

. . . [A]ny implied exception to the plain mandate of the Antideficiency Act would have to rest on a rationale that would undermine the statute. The manifest purpose of the Antideficiency Act is to insure that Congress will determine for what purposes the Government's money is to be spent and how much for each purpose. This goal is so elementary to a proper distribution of governmental powers that when the original statutory prohibition against obligations in excess of appropriations was introduced in 1870, the only responsive comment on the floor of the House was, 'I believe that is the law of the land now.' Cong. Globe, 41st Cong., 2d Sess. 1553 (1870)[remarks of Rep. Dawes].<sup>270</sup>

Once an antideficiency law violation has occurred, the affected agency's problem is two-fold: (1) how to minimize the excess liability, and (2) how to achieve the fullest possible

performance.

One of the largest antideficiency violations involved overobligations and ultimate expected cash deficiencies of \$160 to \$180 million. Payments by the Army on the affected contracts -- some 1,200 contracts -- were stopped, and about 900 contractors and suppliers either continued performing or stopped work (justified by this breach of their contracts) awaiting payment. Four Army procurement appropriations had been massively overobligated -- Procurement of Equipment and Missiles, 1971/1973; Other Procurement, 1972/1974; Procurement of Weapons and Tracked Combat Vehicles, 1972/1974; and Procurement of Weapons and Tracked Combat Vehicles Army, 1973/1975.<sup>271</sup>

The Army proposed four possible courses of action, all but one of which -- termination for convenience -- the Comptroller found objectionable, to varying degrees. The Army had also proposed (1) issuance of no cost stop work orders, (2) modifying the affected contracts to encourage continued work on the basis of the contractor assuming the risk of ultimate nonappropriation or insufficient appropriation, and (3) reprogramming current funds to pay these prior year obligations.

The Comptroller immediately rejected the use of current year appropriations as a clear violation of 31 U.S.C. § 1502. He objected to the seeking of contract modifications "to recognize the Government's obligation . . . to pay the full contract amounts," subject to subsequent availability of appropriations," with continued performance to be permitted "at the risk of the contractor in that he would be assuming that legislative relief would be granted."<sup>272</sup> The Comptroller objected to this proposal first because, like the Limitation of Funds/Limitation of Cost clause cases in which contractor relief for excess costs has been considered or granted either under the contract<sup>273</sup> or on a quantum meruit or quantum valebant theory,<sup>274</sup> affected contractors could also choose to litigate the issue whether the United States might be liable under implied in fact contracts.<sup>275</sup> Therefore, the liability-limiting goal might not be achieved by this proposal. Secondly, he objected to contractually seeking to shift the risk to the contractors of later insufficiency of deficiency or supplemental appropriations because congressional options in dealing with the Army's overobligations would be narrowed:

More fundamentally, the Congress would be placed in the position of either accepting a fait accompli and fully appropriating for contract performance or, by refusing to fully appropriate, allowing the Army a windfall at the expense of the contractors -- a result which seems inequitable at best.<sup>276</sup>



Short of termination for convenience settlements of affected contracts where the cost of termination would not exceed available funds, the Comptroller found least objectionable the proposal to temporarily cease performance under "no cost stop work orders," which the Army believed would leave the contracts in effect pending its request for supplemental appropriations to cure the deficiency and also to complete performance under the contracts, or for deficiency appropriations to liquidate the Antideficiency Act violation.<sup>277</sup>

### Chapter III: Footnotes

1. This limitation was apparently intended as a barrier to the establishment of a permanent land army supported by a permanent appropriation. It appears that a permanent navy was not so feared. See Hamilton (Publius), *The Federalist*, No. 26 (1787); 40 Op. Att'y Gen. 555 (1948); 25 Op. Att'y Gen. 105 (1904).
2. See *Cincinnati Soap Co. v. United States*, 301 U.S. 308 (1937).
3. 6 Op. Att'y Gen. 27 (1853).
4. 5 Pet. 115, 128, 30 U.S. 83 (1831) (emphasis added).
5. 10 U.S.C. § 2306 (a).
6. 10 U.S.C. § 2202; 5 U.S.C. 301.
7. Such as 31 U.S.C. § 1341 and 41 U.S.C. § 11.
8. *Perkins v. Lukens Steel Co.*, 310 U.S. 113, 127 (1940).
9. 218 U.S. 322, 333-335 (1910).

10. Opinion of the Attorney General to the President, January 16, 1981.

11. See *Bradley v. United States*, 98 U.S. 104 (1978).

12. A good example of contract authority is Section 22 of the Arms Export Control Act of 1976, Pub. L. No. 94-329, 90 Stat. 729, codified in several sections of Title 22, United States Code, principally at 22 U.S.C. § 2751 et seq., which authorizes contracts for procurement of defense articles or services for sale to a foreign country or international organization based on that country's "dependable undertaking" to pay the full amount and to make sufficient funds available in advance to meet costs under the contract, "without requirement for charge to any appropriation or contract authorization otherwise provided." See *Federal Electric Corp.*, ASBCA No. 24002, 82-2 BCA ¶ 15,862 (1982), aff'd Appeal Doc. No. 830571 (Fed. Cir., July 19, 1983)(Unpub.).

13. *Moses v. United States*, 166 U.S. 571 (1871); *Floyd Acceptances*, 74 U.S. 666 (1869). A good example of the use of borrowing authority, as well as of the material breach resulting when sufficient funds are not provided to pay obligations validly created under that authority, is *Northern Helix Co. v. United States*, 455 F.2d 546 (Ct. Cl. 1972).

14. 28 Comp. Gen. 163 (1948).

15. Shipman v. United States, 18 Ct. Cl. 138, 147 (1883).

16. See generally, R. Nash and J. Cibinic, I Federal Procurement Law 665-677 (1977). For the sake of consistency, an attempt has been made to use terms as defined in GAO, A Glossary of Terms Used in the Federal Budget Process and Related Accounting, Economic and Tax Terms (3d ed. 1981), hereafter cited as Budget Terms.

17. Budget Terms at 68.

18. Budget Terms at 69.

19. Budget Terms at 60.

20. In the 1984 Budget, these included grants to states for medicaid, benefits for disabled coal miners, the child support enforcement program, and the like. H. Doc. No. 98-4, 98th Cong., 1st Sess., at V-3.

21. Budget Terms at 31, 43.

22. H. Doc. No. 98-4, 98th Cong., 1st Sess., at V3-V4.

23. FAR 13.101 ("Bulk funding").
24. Budget Terms at 43, 82; Comp. Gen. Dec. B-200519, November 28, 1980, unpub.
25. Budget Terms at 58, 64.
26. Comp. Gen. Dec. B-201110, March 16, 1981, unpub., at 3;
27. Comp. Gen. 96 (1947); Budget Terms at 65, 76. The Comptroller clearly stated the relationship between merged surplus accounts and "M" accounts in Comp. Gen. Dec. B-201110, March 16, 1981, unpub. at 1-2:

The merged surplus authority cannot be used to meet Defense's current needs unless it is authorized by the Congress.

The procedures for accounting for appropriations after they have expired are set forth in 31 U.S.C. [1551-1557]. Once an appropriation has expired, it is no longer available for obligation. Any unobligated balance in such an appropriation is then 'withdrawn' and reverts to its source, either the general fund of the Treasury or a special or trust fund (31 U.S.C. [1552]). These withdrawn balances constitute the merged surplus as opposed to the merged obligated balances which are retained in separate accounts for the purpose of liquidating obligations properly made before the appropriation's expiration -- the so-called "M" accounts.

Once the unobligated balance of an expired appropriation is withdrawn, it is legally available only for restoration to the "M" account to liquidate obligations or effect adjustments properly attributable to an earlier fiscal year (31 U.S.C. [1552]). We understand that Treasury currently

determines the amount of unobligated balances of expired appropriation accounts only when it is necessary to restore funds from these unobligated balances in order to liquidate previously made obligations. Treasury does this by adding withdrawals previously made from expired appropriation accounts and subtracting from this total all previous restorations to obligated balance "M" accounts.

To make the expired unobligated balances again available for new obligations is generally prohibited (2 U.S.C. 190f(c)). At least, it requires an act of Congress. (See, for example, the operation and maintenance appropriations for the Army, Navy, and Air Force in the Department of Defense Appropriation Act. . . .)

If the Congress authorizes the use of the expired unobligated balances of appropriations to meet current needs, that action would be considered new budget authority. Since the accumulated withdrawals revert either to the general fund of the Treasury or the special or trust fund from which they are derived, they are no longer available for obligation. Therefore, there is no present "budget authority" within the meaning of section 3(a)(2) of the Congressional Budget and Impoundment Control Act of 1974 [2 U.S.C. 622] which defines budget authority as 'authority provided by law to enter into obligations which will result in immediate or future outlays involving Government funds.' It follows that any act of Congress which creates legal authority to obligate expired unused obligational authority results in new budget authority for the fiscal year for which it is authorized. Further, it makes no difference whether the Congress' action to extend the period of availability of obligational authority takes place before or after its original expiration date, since in either case the action creates new budget authority for the particular fiscal year for which it is made available.

27. 31 U.S.C. § 1301 (b).

28. Budget Terms at 56, 79. See Comp. Gen. Rep. B-183134, March 16, 1979, unpub. (report on NASA's FY 1979 supplemental

budget request for \$185 million for the Space Shuttle program, justified on the basis that denial would cause slippage of at least six months and consequent greater expense later).

29. Budget Terms at 55-56; see 31 U.S.C. § 1515.

30. See, e.g., 31 U.S.C. § 5142 (establishing the Bureau of Engraving and Printing's revolving fund); 44 U.S.C. § 309 (establishing the Government Printing Office's revolving funds); 10 U.S.C. § 2208 (which authorizes DOD industrial funds created by DOD Directive 7410.4). 31 U.S.C. § 1516 permits such funds to be exempt from apportionment, but OMB and GAO both maintain that nonapportioned funds, too, are subject to the provisions of OMB Circular A-34 regarding availability of budgetary resources. GAO Report AFMD-81-53 (B-195316), "The Air Force Has Incurred Numerous Overobligations In Its Industrial Fund," August 14, 1981. In that report, the Comptroller maintained that the Air Force practice of obligating not only balances on deposit with the Treasury consisting of accounts receivable and unfilled customer orders, but also anticipated customer orders, violated the Antideficiency Act. The Air Force used this expanded budgetary authority to finance multi-year depot maintenance contracts. GAO recommended that contract authority be given.

31. Budget Terms at 48.

32. 31 U.S.C. § 1511 et seq.; 36 Comp. Gen. 699 (1957).

33. Pub. L. No. 93-344, Title X, 88 Stat. 297 (1974),  
codified at 2 U.S.C. §§ 681-688.

34. See, e.g., Comp. Gen. Dec. B-213283, June 11, 1984,  
unpub.

35. Vink, The Effect of the Legislative Veto on Title X of  
the Budget and Impoundment Control Act, 29 Armed Forces  
Comptroller 12, 16 (1984).

36. See 61 Comp. Gen. 482 (1982); 54 Comp. Gen. 453  
(1974)(explaining the Comptroller's interpretation of the  
Act).

37. Comp. Gen. Dec. B-204825, May 29, 1984, unpub.

38. 13 Op. Att'y Gen. 289, 292 (1870). As examples, the  
reader might compare these related laws, all enacted in the  
first session of the 98th Congress: Supplemental  
Appropriations Act, 1983, Pub. L. No. 98-63, July 29, 1983, 97  
Stat. 301; DOD Authorization Act, 1984, Pub. L. No. 98-94,  
September 24, 1983, 97 Stat. 614; Continuing Appropriations



Joint Resolution, 1984, Pub. L. No. 98-107; Military Construction Authorization Act, 1984, Pub. L. No. 98-115, October 11, 1983, 97 Stat. 757; Military Construction Appropriations Act, 1984, Pub. L. No. 98-116, October 11, 1983, 97 Stat. 795; DOD Appropriations Act, 1984, Pub. L. No. 98-212, December 8, 1983, 97 Stat. 1421.

39. GAO, Principles of Federal Appropriations Law 3-2 (1st ed. 1982).

40. 31 U.S.C. § 1301 (d).

41. 35 Comp. Gen. 306 (1955); 16 Comp. Gen. 1007 (1937).

42. See 61 Comp. Gen. 532 (1982).

43. See Chapter II.A.3.

44. 26 Comp. Gen. 545 (1947); 18 Comp. Gen. 713 (1939); 18 Comp. Gen. 533 (1938).

45. Comp. Gen. Dec. B-151087, September 15, 1981, unpub.

46. GAO, Principles of Federal Appropriations Law 5-103 (1st ed. 1982).

47. See, e.g., DOD Authorization Act, 1984, Pub. L. No. 98-94, § 1202 (a)(1), September 24, 1984, 97 Stat. 614, 679-681.

48. Comp. Gen. Dec. B-200766, September 10, 1981, unpub.; 42 Comp. Gen. 226 (1962); 26 Comp. Gen. 545 (1945); see generally, R. Nash and J. Cibinic, I Federal Procurement Law 657-665 (1977).

49. *Morton v. Ruiz*, 415 U.S. 199 (1974); *Associated Electric Cooperatives, Inc. v. Morton*, 507 F.2d 1167, 1174 (1974); *Winston Bros. Co. v. United States*, 131 Ct. Cl. 245 (1945); *United States v. Bridge Comm'n of Michigan*, 109 F.Supp. 690 (E.D. Mich. 1953); 35 Comp. Gen. 220 (1955)

50. *Julie Research Laboratories, Inc.*, Comp. Gen. Dec. B-213143, 84-1 CPD ¶ 294 (1984); 55 Comp. Gen. 812 (1976); 55 Comp. Gen. 307, 317-318 (1975). See Comp. Gen. Dec. B-200766, September 10, 1981, unpub., for an illustration of the difficulty of administratively determining the availability of funds.

51. *United States v. Dickerson*, 310 U.S. 554 (1940); 38 Comp. Gen. 758, 762 (1959); cf. 2 Comp. Gen. 133 (1922).

52. R. Nash and J. Cibinic, I Federal Procurement Law 663 n.1

(1977).

53. 54 Comp. Gen. 799 (1975).

54. See generally, R. Nash and J. Cibinic, I Federal Procurement Law 658 (1977).

55. DOD Appropriation Act, 1984, Pub. L. No. 98-212, Title VII, §§ 701-799H, December 8, 1983, 97 Stat. 1421,1437-1458.

56. DOD Directive 7250.5, January 19, 1980; DOD Instruction 7250.10, January 10, 1980.

57. 55 Comp. Gen. 307, 328 (1975).

58. See 60 Comp. Gen. 208, 210 (1981).

59. See Section B.3.c.

60. 18 Comp. Gen. 969 (1939).

61. DOD Appropriations Act, 1984, Pub. L. No. 98-212, §711, December 8, 1983, 97 Stat. 1421, 1439.

62. Id. at 97 Stat. 1421-1437.

63. 44 Comp. Gen. 399, 401 (1965); 35 Comp. Gen. 692 (1956); 35 Comp. Gen. 319 (1955), modified by Comp. Gen. Dec. B-125444, February 16, 1956, unpub.; 34 Comp. Gen. 432 (1955).

64. 55 Comp. Gen. 768 (1976); 37 Comp. Gen. 155 (1957); 36 Comp. Gen. 683 (1957).

65. See DOD Appropriations Act, 1984, Pub. L. No. 98-212, § 717, December 8, 1983, 97 Stat. 1421, 1441 (which also limits obligation of one-year funds during the last two months of the fiscal year to no more than 20 per cent of the annual funds appropriated).

66. 20 Comp. Gen. 436 (1941).

67. 38 Comp. Gen. 628 (1959); 37 Comp. Gen. 155 (1957).

68. *Wilder v. United States*, 16 Ct. Cl. 528 (1880), quoted in 37 Comp. Gen. 155, 158 (1957).

69. 37 Comp. Gen. 155, 159 (1957). Cf. GAO Report No. NSIAD-85-12, "Results of GAO's Review of DOD's Fiscal Year 1985 Ammunition Procurement and Production Base Programs," October 23, 1984.

70. 36 Comp. Gen. 683 (1957).

71. 48 Comp. Gen. 497 (1969).
72. 60 Comp. Gen. 219 (1981).
73. DOD Appropriation Act, 1984, § 708(f), (j) (o), Pub. L. No. 98-212, 97 Stat. 1421, 1438. See also 42 U.S.C. § 2459a.
74. Pub. L. No. 98-212, § 708 (m) and (n), 97 Stat. 1421, 1438.
75. 61 Comp. Gen. 185 (1981); 35 Comp. Gen. 319 (1955); 27 Comp. Gen. 764 (1948).
76. 60 Comp. Gen. 452 (1981); 60 Comp. Gen. 219 (1981); 23 Comp. Gen. 370 (1943)(These rules were applied in DAR 7-104.91(b)); see Comp. Gen. Dec. B-187881, October 3, 1977, unpub. (disapproving proposal to permit school bus and school teacher contracts for whole academic years crossing fiscal years as bona fide needs violations).
77. See Section B.3.i. Title 31, United States Code, has been enacted into positive law by Pub. L. No. 97-258, September 13, 1982, 96 Stat. 927. Considerable confusion awaits those who attempt to trace through previous decisional law, since cases have tended to cite various mixtures of the

Revised Statutes, and the previous unofficial codification of the Revised Statutes. Now, of course, the new statutory sections and language also will be cited.

78. See cases and discussion in Section B.3.i.

79. 39 Comp. Gen. 776 (1960); 39 Comp. Gen. 340 (1959).

80. 56 Comp. Gen. 437 (1977); see *C. H. Leavell and Co. v. United States*, 530 F.2d 878 (Ct. Cl. 1976); Comp. Gen. Dec. B-196132, October 11, 1979, unpub.; Comp. Gen. Dec. B-164497, June 6, 1979, unpub.; 28 Comp. Gen. 163 (1948).

81. 29 Comp. Gen. 504 (1950).

82. Comp. Gen. Dec. B-195260, July 11, 1979, unpub.; 48 Comp. Gen. 494 (1969).

83. 271 U.S. 204 (1925).

84. 61 Comp. Gen. 184 (1981).

85. Comp. Gen. Dec. B-190659, October 23, 1978, unpub.

86. See 55 Comp. Gen. 812 (1976); 47 Comp. Gen. 155 (1967); 42 Comp. Gen. 272 (1962).

87. 60 Comp. Gen. 86 (1980).

88. For OMB implementation, see OMB Circular A-34, "Instruction on Budget Execution," July 1976, applicable to the agencies. Within DOD and its components, these statutory restrictions are reflected in many implementing regulations. The most central DOD regulatory and interpretatory implementations include: DOD Directive 7200.1, "Administrative Control of Appropriations," November 15, 1978; DOD Directive 7220.8, "Policies and Procedures Governing the Use of the Authority of Section 3730, Revised Statutes," August 16, 1956; DOD Manual 7110-1-M, "DOD Budget Guidance Manual," July 8, 1982; DOD Handbook 7220.9-H, "Accounting Guidance Handbook;" DOD Directive 7250.5, "Reprogramming of Appropriated Funds," January 9, 1980; DOD Instruction 7250.10, "Implementation of Reprogramming of Appropriated Funds," January 10, 1980. As examples of the agencies' further regulation and interpretation of these laws, within the Air Force see AFM 110-4, "Fiscal Law," May 1, 1974; AFR 170-8, "Accounting for Obligations," November 1, 1981; AFM 172-1, "USAF Budget Manual," Volume 1, April 30, 1984; AFP 172-4, "The Air Force Budget Process," October 1, 1984; AFR 172-14, "Full Funding of Air Force Procurement Programs," June 1, 1984; AFR 177-16, "Administrative Control of Appropriations," August 13, 1980; AFM 177-100, "General Principles, Standards,

and Policies of the Air Force Accounting and Finance System," March 22, 1971.

89. 42 Comp. Gen. 272, 275 (1962), quoted in Hopkins and Nutt, The Antideficiency Act (Revised Statutes § 3679) and Funding Federal Contracts: An Analysis, 80 Mil. L. Rev. 51, 112 (1978). This article is the best published treatment of contracting fiscal law principles found. A more comprehensive and more current treatment of general fiscal law principles may be found in the General Accounting Office's (GAO) Principles of Federal Appropriations Law (1982). See also Fenster and Volz, The Antideficiency Act: Constitutional Control Gone Astray, 11 Pub. Contr. L. J. 155 (1979), which discusses at great length the authors' views of the effect of asserted Antideficiency Act violations on the validity of affected government contracts; Efros, Statutory Restrictions On Funding of Government Contract, 10 Pub. Contr. L. J. 254 (1978); Spriggs, The Anti-Deficiency Act Comes to Life in U. S. Government Contracting, 10 Nat. Contr. Mgt. J. 33 (1976-77); Thybony, What's Happened To The Basics, 9 Nat'l Contract Mgt. J. 71, 76 (1975); Whelan and Dunigan, Government Contracts: Apparent Authority and Estoppel, 55 Geo. L. J. 830, 840-843 (1967); Frazier, Use of Annual Funds With Conditional, Options, or Indefinite Delivery Contracts, 9 A.F. JAG L. Rev. 50 (1966); Whelan, Purse Strings, Payments and Procurement, 1964 Pub. L. 322 (1964).



90. 42 Comp. Gen. at 278.

91. *Id.*, citing as examples of Congress' granting such authority to use annual funds, 10 U.S.C. § 2388 (to contract for storage, handling and distribution of liquid fuels for five-year periods with options to renew for additional long-term periods); 22 U.S.C. § 2162 (b)(to execute long-term agreements committing funds to be appropriated for international development, subject only to annual appropriation of funds for such purposes); and 43 U.S.C. § 388 and 48 U.S.C. § 50d (to incur obligations for the purchase of materials, supplies, and equipment in advance of and in excess of appropriations for such purposes). See also 41 U.S.C. § 11a (permitting the Secretary of the Army to buy one years' fuel needs without regard to the current fiscal year, payments to be made from either current or subsequent fiscal year supplies appropriations); 39 U.S.C. §§ 6402, 6405 (mail contracts permitted for two and four year terms); ; 22 U.S.C. § 2393; 10 U.S.C. §§ 2314, 2306 (g) (h).

92. Comp. Gen. Dec. B-201110, March 16, 1981, unpub. at 3.

93. Comp. Gen. Dec. B-193573, December 19, 1979, unpub. (addressing the status of the Saint Lawrence Seaway Corp.); see 39 U.S.C. § 201 (United States Postal Service enabled as

an "independent establishment of the executive branch,"), and 39 U.S.C. § 2003 establishing the Postal Service revolving fund; 31 U.S.C. § 1101; Comp. Gen. Dec. B-201607, January 19, 1981, unpub. (reporting examination of the balance sheets of the Overseas Private Investment Corp. (OPIC) under the Government Corporation Control Act, 31 U.S.C. §§ 841-869).

94. Federal Crop Ins. Corp. v. Merrill, 332 U.S. 380, 384 (1947); Sutton v. United States, 256 U.S. 575, 579 (1921); Curtis v. United States, 2 Ct. Cl. 144 (1866).

95. 21 Op. Att'y Gen. 248 (1895).

96. Chase v. United States, 155 U.S. 489 (1894); 19 Op. Att'y Gen. 654 (1890); 15 Op. Atty. Gen. 235 (1877).

97. Fowler v. United States, 3 Ct. Cl. 43 (1867).

98. Sutton v. United States, 256 U.S. 575, 581 (1921); Shipman v. United States, 18 Ct. Cl. 138 (1883).

99. The City of Los Angeles v. United States, 107 Ct. Cl. 315, 334 (1946).

100. See DOD Directive 7220.8, "Policies and Procedures Governing the Use of the Authority of Section 3730, Revised

Statutes," August 16, 1956.

101. Formerly codified at 31 U.S.C. § 200. The Comptroller has held this statute only restricts obligation of appropriated funds. Robert P. Maier, Inc., Comp. Gen. Dec. B-185177, 76-1 CPD ¶ 137 (1976). Title 31, United States Code, was enacted into positive law by Pub. L. No. 97-258, September 13, 1982, 96 Stat. 927. Citations herein will be to the new provisions, with references in the notes to the sources of relevant component subsections. See generally, R. Nash and J. Cibinic, I Federal Procurement Law 670-673 nn.2-5 (1977).

102. See Comp. Gen. Dec. B-198204, May 1, 1980, unpub. (oral notice of award was given in fiscal year 1979, but the written acceptance was not mailed until fiscal year 1980, preventing the formation of a "binding agreement" until fiscal year 1980); 59 Comp. Gen. 431 (1980); 40 Comp. Gen. 147 (1960). Cf. Comp. Gen. Dec. B-207557, 31 CCF ¶ 71,435 (1983)(Comptroller used equitable relief authority under 31 U.S.C. § 3702 to grant quantum meruit recovery); 61 Comp. Gen. 509 (1982). In the Air Force, Miscellaneous Obligating Documents (MOD's) are prescribed to provide written evidence of contracts or other obligations when the normal documentation has not been received before the end of each monthly accounting period. An MOD may be a letter, memorandum

or electrical message. See AFR 170-8 and AFM 177-100, note 88 supra.

103. 38 Comp. Gen. 81, 82-83 (1958); see H. R. Rep. No. 2663, 83d Cong., 2d Sess. 18 (1954):

It is not necessary, however, that this binding agreement be the final, formal contract on any specified form. The primary purpose is to require that there be an offer and an acceptance imposing liability on both parties.

See 35 Comp. Gen. 319 (1955); 31 Comp. Gen. 608 (1952).

104. United States v. American Renaissance Lines, Inc., 494 F.2d 1059 (D.C. Cir. 1974); Narva Harris Const. Corp. v. United States, 574 F.2d 508 (Ct. Cl. 1978).

105. Comp. Gen. Dec. B-197274, February 16, 1982, unpub., at 3.

106. 31 U.S.C. § 1502 (b).

107. See Comp. Gen. Dec. B-197274, February 16, 1982, unpub., in which HUD's practice of recording "obligations" before they became enforceable by the other party was disapproved because it resulted in the creation of large, unobligated balances when large numbers of such "obligations" were later deobligated.

108. 51 Comp. Gen. 631, 633-34 (1972).
109. See Comp. Gen. Dec. B-197274, February 16, 1982.
110. See FAR 52.202-1, 52.243-1. 52.243-1 ALT I, 52.243-2, 52.243-2 ALT II; DOD FAR Sup. 52243-7000 and 7001, DAR 7-103.2; FAR 52.249-1, 52.249-2; DOD FAR Sup. 52.249-7000 (DAC No. 84-3, March 15, 1984), DAR 7-103.2; FAR 17-208, DOD FAR Sup. 17.2-1, DAR 1-1506.
111. 18 Comp. Gen. 363 (1938); see generally, R. Nash and J. Cibinic, I Federal Procurement Law 671-673 nn.3-5 (1977).
112. See DOD FAR Sup. Part 4 ("Administrative Matters").
113. 34 Comp. Gen. 418 (1955).
114. R. Nash and J. Cibinic, I Federal Procurement Law 673 (1977).
115. California-Pacific Utilities v. United States, 194 Ct. Cl. 703 (1971).
116. 56 Comp. Gen. 142, 156 (1976); 16 Comp. Gen. 803 (1937); 7 Comp. Gen. 507 (1928).

117. 42 Comp. Gen. 708, 712-713 (1963).

118. R. Nash and J. Cibinic, I Federal Procurement Law 672 (1977); 37 Comp. Gen. 691 (1958).

119. H. R. Rep. No. 349, 90th Cong., 1st Sess. 41 (1967); cf. 43 Comp. Gen. 657 (1964).

120. See FAR 28.308.

121. 54 Comp. Gen. 824 (1975); 16 Comp. Gen. 803 (1937); but see DAR 7-203.22 and 7-402.26 (cost reimbursement supply and research and development contracts Insurance-Liability to Third Persons clause purported to indemnify contractors without restriction -- as exceptions to the Limitation of Cost or the Limitation of Funds clauses -- for their liability to third persons for loss of or damage to property and for death or bodily injury arising out of performance of the contract which is not otherwise compensated by insurance). A similar FPR clause was determined to violate the Antideficiency Act in B-201072, May 3, 1982, unpub., and the DAR Council was advised by letter dated May 3, 1982. On July 16, 1982, the DAR Council granted a blanket deviation permitting all Departments to limit liability to appropriations available for payment at the time of the loss, pending action on DAR Case 82-72

examining the whole question of unfunded contingent obligations. The FAR reflects the limitation to available funds. FAR 52.228-7. See R. Nash and J. Cibinic, II Federal Procurement Law 1935-1937 n.11 (3d. ed., 1980); Smith, Indemnification of Government Contractors, Gov't Contr. Briefing Paper No. 82-5 (1982).

122. 42 Comp. Gen. 708 (1963), as modified by 54 Comp. Gen. 824 (1975); 35 Comp. Gen. 85 (1955); 12 Comp. Gen. 390 (1932).

123. Reimbursement of State of New York Under Olympic Support Contract, Comp. Gen. Dec. B-202518, 82-2 CPD ¶ 2 (1982) at 3-4:

Reimbursement is limited to funds appropriated for the 1980 Olympic Games. More specifically, such payment may not exceed those funds available for this purpose on February 3, 1980, the date on which the accident took place. Since funds for reimbursement were not obligated until well after this date, the Army risked violation of the Antideficiency Act . . . during the period between the date on which its liability became fixed (i.e. the date of the accident) and the date on which it obligated funds (i.e. the date of receipt of the State's August 25, 1980 claim for reimbursement) because of the possibility that sufficient funds would not have remained to liquidate the State's claim at that time. An estimated amount for this liability should have been obligated upon receipt by the Army of notification of [the employee's] injury. No violation actually occurred, however, because sufficient funds remained available for obligation at the time at which the State filed its claim.

124. GAO, Principles of Federal Appropriations Law 6-49

(1982).

125. See generally R. Nash and J. Cibinic, II *Federal Procurement Law*, Chapter 27, § 2, and Chapter 32 at 2276-2285 n.3 (3d ed. 1980). This remains the Comptroller's policy:

GAO is aware and remains concerned that the guidance provided in [its] decisions does not solve all problems. For example, limiting an indemnification agreement to appropriations available at the time of the loss . . . may remove the 'unlimited liability' objection, but it remains entirely possible that liabilities incurred under such an agreement could exhaust the agency's appropriation and produce further Antideficiency Act complications. If an agency thinks that indemnification agreements in a particular context are sufficiently in the Government's interests, GAO's preference is for the agency to go to Congress and seek specific statutory authority.

GAO, *Principles of Federal Appropriations Law* 6-49, 50 (1982).

126. The procedure for indemnification requests is found at FAR 50.403, DOD FAR Sup. 50.4-1, 35.070-071, 52.235-7000-7004, DAR 10-701, 17-303.61, 7-403.56.

127. 72 Stat. 972, 50 U.S.C. §§ 1431-1435, as amended by Pub. L. No. 93-155, § 807 (a), 87 Stat. 615 (1973). The broad power of Pub. L. No. 85-804 has been used for extraordinary contractual adjustments (including amendments without consideration based on essentiality of the contractor to the national defense, amendments without consideration based on



government actions, correction of mistakes, and formalization of informal commitments), advance payments, and the exercise of certain "residual powers" such as the power to insert special contract clauses like indemnification clauses into contracts. See FAR 50.401-403, DOD FAR Sup. 50.403-70, DAR 17-103, 302-303; FPR 1-17.103.

Executive Order 10789, 23 Fed. Reg. 8897 (1958), limited other types of relief under Pub. L. No. 85-804 to the amount appropriated, but by Executive Order 11610, 36 Fed. Reg. 13755 (1971), the indemnity authority covering claims or losses resulting from risks the contract defines as unusually hazardous or nuclear has been specifically exempted from this limitation. Executive Order 10789 has also been amended by Executive Orders 11051, 27 Fed. Reg. 9683 (1962), and 11382, 32 Fed. Reg. 16,247 (1962). The orders extend the authority of Pub. L. No. 85-804 to 11 agencies. NASA decided as a matter of policy not to use the Pub. L. No. 85-804 authority for indemnification, see NASA PR 10.350.

DAR 17-303.2 provided contracting officers may deny contractor requests for indemnification, but that approvals would be based on the contracting officer's recommendations although they might only be effected by a Memorandum of Approval executed by the Secretary of the Department. Requests for indemnification had to be based on definitions of

unusually hazardous or nuclear risks that could impose a liability upon the contractor in excess of financial protection reasonably available, and these definitions were incorporated in the contract. DAR 17-303.2 (b)(iv). The indemnity clause to be used was specified by DAR 10-702. See DAR 7-303.62, 7-403.57.

128. See generally R. Nash and J. Cibinic, II Federal Procurement Law, Chapter 27, § 2, 1855-1857, 1931-1939 nn.10-12 (3d ed. 1980).

129. See *Les Etablissements Eiffel-Asie*, 80-2 BCA ¶ 14,500 (1980).

130. 42 U.S.C § 2210. See *Duke Power Co. v. Carolina Environmental Study Group*, 438 U.S. 59 (1958); *Silkwood v. Kerr-McGee Corp.*, 485 F. Supp. 566, aff'd in part rev'd in part, 667 F.2d 908 (10th Cir. 1981); *McKay v. United States*, 703 F.2d 464 (10th Cir. 1983). The \$560 million liability ceiling included in the act was widely attacked after the Three Mile Island facility accident, and unsuccessful legislative proposals to eliminate it were initiated in both Houses.

131. 42 U.S.C. § 2210 (j).

132. 22 U.S.C. § 2393.

133. 38 U.S.C. § 4101.

134. 42 U.S.C. § 2458b.

135. See generally, Rhodes, Liability Insurance and the Space Shuttle, 88 Case and Comment 28 (1983); 43 Fed. Reg. 10808 (February 19, 1980); 45 Fed. Reg. 74499 (November 10, 1980).

136. See Hill, Permissible Scope of Military Activity in Outer Space, 24 A. F. L. Rev. 157, 166-67 (1984).

137. See generally R. Nash and J. Cibinic, II Federal Procurement Law 1937-1939 n.12 (3d. ed, 1980).

138. Fenster and Volz, The Antideficiency Act: Constitutional Control Gone Astray, 11 Pub. Contract L. J. 155, 208 (1979).

139. Formerly codified at 31 U.S.C. § 628-1.

140. See Comp. Gen. Dec. B-203554, September 10, 1981, unpub.; Comp. Gen. Dec. B-195775, October 10, 1979, unpub.

141. Fenster and Volz, note 138 supra at 155, 159.

142. 10 U.S.C. § 126; 31 U.S.C. § 1531.

143. See, e.g., Ball Bros. Research Corp., NASA BCA No. 1277-6, 80-2 BCA ¶ 14,526 at 71,609 (1980). See also GAO Report No. FGMSD-75-52, "Reimbursement To Appropriations: Legislative Suggestions for Improved Congressional Control," November 1, 1976. See DOD FAR Sup. 8.7006-1.

144. See FAR 42.101, implementing the authority of the Economy Act for intragovernmental procurement; Comp. Gen. Dec. B-215754, September 28, 1984, unpub.

145. See DOD Directive 7250.5, January 14, 1975; DOD Instruction 7250.1, January 14, 1975. A good illustration of the need for administrative flexibility was reported by GAO in "An Analysis of DOD's Family Housing Management Account and Lease Construction Agreements," Report No. CED-80-53 (B-197149), February 2, 1980 at 4, 6-7 where the Comptroller noted frequent transfers between the accounting categories "operations" and "maintenance" both included within the Family Housing Management account -- the account was divided into debt payment, energy consumption metering, and operation and maintenance (further subdivided into management, services, utilities, furnishings, miscellaneous, and leasing). This transfer practice was approved because, although the account was justified to the Congress on the subdivision level, the

appropriation itself was lump-sum.

DOD Directive 7250.5, January 9, 1980, and DOD Instruction 7250.10, January 10, 1980, controlling reprogrammings, do require prior approval by both the House and Senate Committees on Armed Services and the House and Senate Committees on Appropriations before effecting reprogrammings in cases involving weapons procurement increases above those authorized under 10 U.S.C. § 138, matters identified as special interest items, and uses of the general transfer authority provided in each appropriations act. Before 1982, prior notification of these committees following approval by the Secretary of Defense or his deputy was required when reprogramming involves an increase of \$5 million or more in the military personnel or the operation and maintenance appropriations, procurement appropriation increase of \$5 million or more or a procurement addition of \$2 million or more, "an increase of \$2 million or more in any program element in an appropriation for RDT and E, including the addition of a new program of \$2 million or more or the addition of a new program the cost of which is estimated to be \$10 million or more within a 3-year period," and for other actions below those thresholds which will result in "significant follow-on costs." As noted in the text, the reprogramming thresholds were raised to \$4 million for RDTE, and \$10 million for procurement by agreement with the

Committees during deliberations on the FY 1982 appropriations bill. Even below-threshold reprogrammings must be sent for advance notification to the House and Senate Committees on Appropriations, if "new starts" are involved (programs not previously approved by the Congress). Apparently other reprogrammings may be approved without prior approval or notification by the DOD components.

146. 55 Comp. Gen. 307, 318-319 (1975), citing Fisher, Reprogramming of Funds by the Defense Department, 36 J. Politics 77, 78, 82 (1974); 55 Comp. Gen. 812 (1976).

147. Edgar, The New Acquisitions Environment: Challenge and Opportunity, 5 Concepts 9, 11 (1982).

148. See, e.g., DOD Appropriation Act, 1984, Pub. L. No. 98-212, Title III, 97 Stat. 1421 (emergency and extraordinary expenses, and confidential military purposes); Supplemental Appropriations Act, 1983, Pub. L. No. 98-63, General Provisions, 11 July 1983, 97 Stat. 308, 309: "The amount that may be transferred pursuant to section 732 of the [DOD] Appropriation Act, 1983, is hereby increased to \$1,700,000."

149. 55 Comp. Gen. 812, 820 (1976).

150. Formerly codified at 31 U.S.C. §§ 628, 717, 718, and

627.

151. 18 Op. Att'y Gen. 176 (1885).

152. *Greene County Planning Bd. v. FPC*, 559 F.2d 1227, cert. den., 434 U.S. 1086 (1977); 62 Comp. Gen. 177 (1983); 60 Comp. Gen. 688 (1981); 36 Comp. Gen. 621 (1957). But where one agency acts as agent for the other in procurement, the procuring agency's appropriations restrictions apply, if any, not the using agency's restrictions. *Wilde Tool Co., Inc.*, Comp. Gen. Dec. B-213528, 84-1 CPD ¶ 245 (1984).

153. *Norcross v. United States*, 142 Ct. Cl. 763, 766, mot. for reconsid., 142 Ct. Cl. 767 (1958)(claimant paid on quantum meruit basis, despite illegality of employment contract).

154. 18 Comp. Gen. 285, 292, 295 (1938).

155. *Valley Const. Co. v. Hoffman*, 417 F. Supp. 926 (D. Ga. 1976); 21 Op. Att'y Gen. 414 (1896); 33 Comp. Gen. 423, 424 (1954).

156. 61 Comp. Gen. 419 (1982); 59 Comp. Gen. 415 (1980); 33 Comp. Gen. 423, 424 (1954).

157. 17 Op. Att'y Gen. 480 (1882). 31 U.S.C. § 1535 is one

such source of authority.

158. 35 Comp. Gen. 85, 89 (1955); 26 Op. Att'y Gen. 81 (1906).

159. 27 Op. Att'y Gen. 31 (1908).

160. Comp. Gen. Dec. B-203554, September 10, 1981, unpub.; see also Comp. Gen. Dec. B-195775, October 10, 1979, unpub. (permitting Merit Pay systems to be funded on an agency-wide basis by pooling of appropriations).

161. See 21 Op. Att'y Gen. 304 (1896).

162. 41 U.S.C. § 260.

163. 10 U.S.C. § 2314.

164. See 22 U.S.C. § 2393; Executive Order 11223, May 12, 1965, 30 Fed. Reg. 6635.

165. 31 U.S.C. § 5114.

166. Id.

167. 10 U.S.C. § 2306 (g) (h).



168. 10 U.S.C. § 2394.

169. (Emphasis added). Formerly codified at 31 U.S.C. §§ 200 (d) and 712a.

170. *Norcross v. United States*, 142 Ct. Cl. 763, mot. for reconsid., 142 Ct. Cl. 767 (1958). See, e.g., Comp. Gen. Dec. B-203788, July 7, 1987, unpub. (although the agency had been explicitly granted multiple-year leasing authority in its 1981 appropriations act, that authority would end with fiscal year 1981, unless first exercised).

171. 55 Comp. Gen. 768, 773 (1976).

172. See 55 Comp. Gen. 768, 773 (1976).

173. 50 Comp. Gen. 589, 591 (1971); 23 Comp. Gen. 370 (1943); 22 Comp. Gen. 156 (1942); see generally, R. Nash and J. Cibinic, *I Federal Procurement Law* 675-676 nn.1-3 (1977). Statutory exemptions are not unknown: 41 U.S.C. § 11a (Army authorized to buy fuel for one year without regard to fiscal year, payment to be from current funds, or from funds later appropriated).

174. 34 Comp. Gen. 239 (1954); 38 Comp. Gen. 190 (1958).

175. Lawrence W. Rosine Co., Comp. Gen. Dec. B-185405, 76-2 CPD ¶ 159 (1956).

176. 24 Comp. Gen. 555 (1945)(contract mutually rescinded in prior fiscal year); 38 Comp. Gen. 190, 193 (1958), in which the Comptroller disavowed prior conflicting decisions:

[I]t is sufficient to note that they either deal with a situation in which the first contract was terminated for default or for convenience but nevertheless represented a valid and binding contract up to the point of termination, or were decided prior to section 1311 of the Supplemental Appropriation Act of 1955 [now codified at 31 U.S.C. § 1501]. . . .

. . . .

Since the enactment of section 1311, it has been our position that in situations such as here presented, the awards having been determined to be invalid, no binding agreement ever existed as required under [section 1501], and therefore the funds cannot be regarded as obligated until such time as a binding agreement in writing may be entered into.

177. 32 Comp. Gen. 565 (1953).

178. 60 Comp. Gen. 591, 595-596 (1981) (emphasis added); see 59 Comp. Gen. 518 (1980).

179. Comp. Gen. Dec. B-195732, June 11, 1980, unpub.

180. 38 Comp. Gen. 628 (1959); 23 Comp. Gen. 943, 945 (1944);

21 Comp. Gen. 574 (1941).

181. 61 Comp. Gen. 609 (1982); 37 Comp. Gen. 861, 863-864 (1958).

182. 61 Comp. Gen. 184, 187 (1981); 44 Comp. Gen. 399 (1965).

183. 24 Comp. Gen. 555 (1945).

184. Comp. Gen. Dec. B-195732, June 11, 1980, unpub.

185. 62 Comp. Gen. 70 (1982).

186. 31 U.S.C. § 3302 (b); 46 Comp. Gen. 555 (1966).  
Statutory exceptions include 10 U.S.C. § 381 (b) and 43 U.S.C. § 401.

187. 46 Comp. Gen. 555, 556 (1966); 44 Comp. Gen. 623 (1965);  
34 Comp. Gen. 577 (1955).

188. 46 Comp. Gen. 555, 556 (1966); 23 Comp. Gen. 365 (1943).

189. Formerly codified at 31 U.S.C. §§ 529, 530a, 530b, and  
686-2.

190. *Williams v. United States*, 1 How. 290, 11 L. Ed. 135

(1843).

191. See 10 U.S.C. § 2307; 41 U.S.C. § 255; 57 Comp. Gen. 89 (1977). Other statutory exceptions can be found in 19 U.S.C. § 2076-2080, 10 U.S.C. § 2395, and 37 U.S.C. § 404 (authorizing advance travel and transportation allowances to military personnel). See 54 Comp. Gen. 764 (1975); 40 Comp. Gen. 77 (1960); 39 Comp. Gen. 659 (1960).

192. 10 Op. Att'y Gen. 288 (1862).

193. 1 Comp. Gen. 143, 145 (1921); 28 Comp. Gen. 468 (1949); 20 Comp. Gen. 917 (1941). See, e.g., FAR 32.500; 41 CFR § 1-30.503.

194. 57 Comp. Gen. 89 (1977).

195. 37 Comp. Gen. 60 (1957).

196. 57 Comp. Gen. 399 (1978).

197. 31 U.S.C. § 686; 25 Comp. Gen. 834 (1946).

198. See 10 U.S.C. § 2353 (specific authority for improvements in research work by military research contractors); 53 Comp. Gen. 328 (1973); 51 Comp. Gen. 167

(1971); 42 Comp. Gen. 212 (1962); 38 Comp. Gen. 758 (1959); 38 Comp. Gen. 392 (1959).

199. See generally, R. Nash and J. Cibinic, I Federal Procurement Law 664 nn.3 and 4 (1977).

200. 42 Comp. Gen. 212, 214-215 (1962).

201. See, e.g., Air Force Regulation 86-1, Volume 1, "Appropriated Fund Resources," May 7, 1984.

202. See, e.g., Military Construction Authorization Act, 1984, Pub. L. No. 98-115, October 11, 1983, § 608 (1), 97 Stat. 757, 781.

203. Campanella Const. Co., Comp. Gen. Dec. B-194135, 79-2 CPD ¶ 361 (1979)(but claim submitted to Congress under the Meritorious Claims Act, codified at 31 U.S.C. § 3702 (d)).

204. 40 U.S.C. § 278a.

205. 53 Comp. Gen. 317 (1973); 19 Comp. Gen. 528 (1939); 15 Comp. Gen. 761 (1936).

206. 42 Comp. Gen. 480, 483-484 (1963); 53 Comp. Gen. 351 (1973).

207. Formerly codified at 31 U.S.C. § 665 (a).

208. Formerly codified at 31 U.S.C. § 665 (h).

209. Formerly codified at 31 U.S.C. § 665 (b).

210. 55 Comp. Gen. 812, 824 (1976).

211. Fenster and Volz, note 138 supra at 158 (1979).

212. 59 Comp. Gen. 369 (1980)(State Department could purchase private insurance so long as it explicitly limited government liability to the amount of the premiums).

213. See generally Hopkins and Nutt, note 89 supra. See Act of July 12, 1870, ch. 251, § 77, 16 Stat. 251 (prohibiting creation of "coercive deficiencies"); Act of March 3, 1905, ch. 1484, § 4, 33 Stat. 1257 (covering all "obligations," prohibiting acceptance of voluntary services, and prescribing criminal penalties and apportionment); Act of February 27, 1906, ch. 510, § 3, 34 Stat. 48 (restricting waiver of apportionment); Act of September 6, 1950, ch. 896, § 1211, 64 Stat. 765 (prescribing intricate apportionment and reapportionment process); Pub. L. No. 85-170, § 1401, 71 Stat. (1957); Pub. L. No. 93-198, § 421, 87 Stat. 789 (1973); Pub.

L. No. 93-344, § 1002, 88 Stat. 332 (1974); Pub. L. No. 93-618, § 175 (a)(2), 88 Stat. 2011 (1975).

214. Act of February 12, 1868, ch. 8, § 2, 15 Stat. 35, quoted in Hopkins and Nutt, note 89 supra at 58.

215. 31 U.S.C. §§ 1349, 1350, 1518, and 1519. I have found no reported prosecutions. Also, it seems at least possible that contractors knowingly participating in violation of these punitive sections might be charged as co-conspirators under 18 U.S.C. § 371. See *United States v. Smith*, 496 F.2d 185 (10th Cir. 1974), cert. den., 419 U.S. 964, reh. den., 419 U.S. 984 (1975).

216. 62 Comp. Gen. 1 (1982); 60 Comp. Gen. 440 (1981).

217. See 61 Comp. Gen. 586 (1982); also see GAO Report No. CED-80-53 (B-197149), "An Analysis of DOD's Family Housing Management Account and Lease Construction Agreements," February 2, 1980 at 13-14 (DOD authorized by 10 U.S.C. § 2675 to enter into lease construction agreements several years before appropriations actually provided, and funds were not obligated until units actually occupied); 39 Comp. Gen. 422, 425-426 (1959).

218. See 39 Comp. Gen. 776 (1960); 39 Comp. Gen. 340 (1959).

219. Cited by Hopkins and Nutt, note 89 supra at 72, who conclude: "Thus, the Secretary of Defense has elected by his own regulations to exercise the discretion provided by statute and elevate violations of subdivisions of funds below an apportionment to the level of statutory violations." No doubt this encourages fiscal discipline in the subordinate echelons.

220. Fenster and Volz, note 138 supra at 166 n.27.

221. 31 U.S.C. §§ 1351, 1517 (b).

222. All the reported cases deal with acceptance of voluntary personal services, and this appears to be the accepted scope of § 1342. See, e.g., 60 Comp. Gen. 456 (1981); Comp. Gen. Dec. B-177836, April 24, 1978, unpub.; Comp. Gen. Dec. B-129004, September 6, 1956, unpub. Fenster and Volz, note 138 supra at 165 argue, however, for a more expansive reading:

The provision does not bar only personal services, as its own structure illustrates. It bars the acceptance of any voluntary services, first, and then the employment of personal services, second. . . . The first clause relating to 'voluntary services,' on the other hand, is not limited to personal services, but includes whatever services can have the effect of creating 'moral obligations' which the Congress would feel obliged to fund with deficiency or supplemental appropriations [citing 30 Op. Atty. Gen. 51 (1913), and Frank Lee v. United States, 45 Ct. Cl. 57 (1910)]. Conspicuously included within this prohibition would be any contractual arrangement whereby government



procurement officials solicited or accepted contract performance from a government contractor on a 'temporarily unfunded' basis pending future congressional funding.

So poorly understood is subsection (b) [Section 1342] that regulations actually provide for its systematic violation. Thus, DAR . . . Section 3.405.3 . . . provides for cost-sharing contracts; such contracts are absolutely illegal. Similarly, DAR Section 1-311 . . . tacitly provides for 'buy-in' contracts -- a practice which the GAO has expressly permitted. In either case, the government is knowingly contracting for services, a part of which are 'voluntary.'

The Comptroller may ultimately agree with this position. See GAO, Principles of Federal Appropriations Law 5-36 (1st ed. 1982).

223. Comp. Gen. Dec. B-177836, April 24, 1973, unpub.; Comp. Gen. Dec. B-140736, June 1, 1961, unpub.; 13 Comp. Gen. 108, 111 (1933); 10 Comp. Gen. 248 (1930); 3 Comp. Gen. 681, 682 (1924).

224. Comp. Gen. Dec. B-152554, February 24, 1975, unpub.

225. 60 Comp. Gen. 456 (1981); Comp. Gen. Dec. B-139261, June 26, 1959, unpub.

226. 27 Comp. Gen. 194 (1947); 26 Comp. Gen. 956 (1947).

227. Comp. Gen. Dec. B-204326, July 26, 1982, unpub.

228. DOD Authorization Act, 1984, Pub. L. No. 98-94, § 1266, September 24, 1983, 97 Stat. 614, adding a new section 1588 to Title 31, United States Code.

229. 31 U.S.C. § 1511-1515; 36 Comp. Gen. 699, 702 (1957).

230. 31 U.S.C. § 1515 (b)(1).

231. OMB Circular A-34, "Instructions on Budget Execution."

232. See DOD Directive 7200.1, November 15, 1978, at paragraphs F, G and H.

233. As an example of the complexity of determining violations under this administrative subdivision system, see the special circumstance caused by withdrawal of obligational authority by a higher administrative level described in AFR 177-16, "Administrative Control of Appropriations," August 13, 1980, at paragraph 34:

(1) When a withdrawal of funds by higher headquarters exceeds available balances, no violation exists if funds in like amount can be recouped by withdrawing from subordinate levels, or if the funds withdrawn have not been allocated, or allotted elsewhere and are reissued by the withdrawing agency to cover the over-allotment or overobligation. The activity from which the funds were withdrawn takes immediate action to withdraw funds from subordinate levels, where possible. Where withdrawal from subordinate levels is not possible, notify the withdrawing activity at once.

Make a simultaneous request for the necessary funds. A violation has occurred if the funds cannot be recouped by withdrawal from lower levels, and are not available for reissue by the activity which withdrew the funds if approval was not obtained before withdrawal.

(2) Sometimes a withdrawal of funds does not exceed available balances at the time withdrawn, but a later recording or adjustment of an obligation incurred before the withdrawal causes an overobligation. If funds are still available at the withdrawing activity level, and funds are reissued to cover the overobligation, no violation has occurred. If funds are not available at the withdrawing activity level, the withdrawing agency notifies the withdrawee. The withdrawee reports this violation per these instructions, if the withdrawee approved the amount of withdrawal. If approval was not obtained, the withdrawing activity is responsible for the violation.

234. DOD Directive 7200.1, note 232 supra at paragraph XVII.

235. See generally, R. Nash and J. Cibinic, I Federal Procurement Law 663-664 n.2 (1977).

236. Comp. Gen. Dec. B-187969, May 11, 1977, unpub.

237. Fenster and Volz, note 138 supra at 185.

238. Apparently tacitly acknowledging that remedies under the contract are not available when a contract is found void ab initio, one commentator has suggested an intermediate solution: establishing another category including contract no longer fully enforceable because breached by the government, not voidable because the nonbreaching party may not exercise

the usual contractual right of electing to waive his right to cease work and seek damages by continuing performance under the contract, yet not void ab initio because once concededly legal and binding on both parties -- these contracts would be called rendered void when the government ceases making required payments when available funds are exhausted. Spriggs, The Anti-Deficiency Act Comes to Life in U. S. Government Contracting, 10 Nat'l Contr. Mgt. J. 33, 41-42 (1976-77). The difficulty with this position is that it seeks to have it both ways: to void the contract, but to preserve the remedy of constructive termination under the contract. See Federal Electric Corp. v. United States, 486 F.2d 1377, 1382 (Ct. Cl. 1973), cert. den. 419 U.S. 874 (1974). More straightforward is to describe the result the cases seem actually to have reached -- contracts once valid that violate the Antideficiency Act by exceeding available appropriations with the actual or constructive knowledge of the contractor become void to the extent of the violation.

239. *Leiter v. United States*, 271 U.S. 204 (1926); *Sutton v. United States*, 256 U.S. 575 (1921); *Hoe v. United States*, 218 U.S. 322 (1910); *Ross Construction Corp. v. United States*, 183 Ct. Cl. 694 (1968); *Anthony Miller, Inc. v. United States*, 172 Ct. Cl. (1965).

240. *Doullut v. United States*, 213 F. 729 (1914); *Myerle v.*

United States, 33 Ct. Cl. 1 (1897); Ferris v. United States, 27 Ct. Cl. 542 (1892); Dougherty v. United States, 18 Ct. Cl. 496 (1883).

241. 218 U.S. 322, 334-335 (1910)(emphasis added).

242. 256 U.S. 575 (1921).

243. 271 U.S. 204 (1926); see, e.g., 61 Comp. Gen. 184 (1981); 24 Comp. Gen. 195 (1944).

244. But this result has occurred in contracts cases involving violation of other statutes, see, e.g., G. L. Christian and Assoc. v. United States, 160 Ct. Cl. 1 (1963); Nautilus Shipping Corp. v. United States, 141 Ct. Cl. 391 (1958). Cf. John Reiner and Co. v. United States 169 Ct. Cl. 381 (1965).

245. 172 Ct. Cl. 60 (1965).

246. *Id.* at 72-73 (emphasis added).

247. 183 Ct. Cl. 694.

248. Fenster and Volz, note 138 *supra* at 174.

249. Sutton v. United States, 256 U.S. 575, 581 (1921); Shipman v. United States, 18 Ct. Cl. 138 (1883); Curtis v. United States, 2 Ct. Cl. 144 (1866).

250. Ross Construction Corp. v. United States, 183 Ct. Cl. 694, 699, 392 F.2d 984 (1958); Joplin v. United States, 89 Ct. Cl. 345, 359 (1939); Ferris v. United States, 18 Ct. Cl. 496, .03 (1883).

251. 183 Ct. Cl. at 700; 55 Comp. Gen. 768 (1976).

252. New York Airways, Inc. v. United States, 177 Ct. Cl. 800, 817 (1966).

253. Id. at 815.

254. Id. at 807.

255. See Norcross v. United States, 142 Ct. Cl. 763, mot. for reconsid., 142 Ct. Cl. 767 (1958)(recovery permitted on quantum meruit basis despite clear illegality in violation of appropriations act purpose restriction); 40 Comp. Gen. 447 (1961)(award made to nonresponsive bidder); Dictamatic Corp., Comp. Gen. Dec. B-181038, 74-1 CPD ¶ 260 (1974).

256. Comp. Gen. Dec. B-176133, March 29, 1972, unpub. (the

contractor had agreement that he would be paid if funds later became available); but cf. *Los Angeles v. United States*, 107 Ct. Cl. 315, 334 (1946). See generally, R. Nash and J. Cibinic, *I Federal Procurement Law* 673-674 n.6 (1977).

257. *Bradley v. United States*, 98 U.S. 104 (1878).

258. Pub. L. No. 95-563, § 13, Nov. 1, 1978, 92 Stat. 2389.

259. 28 U.S.C. § 2517; 41 U.S.C. § 612 and 31 U.S.C. 1304 (a); see Whelan and Dunigan, note 89 supra at 842 n.66.

260. See generally, Fenster and Volz, note 138 supra at 194-229.

261. *Id.* at 206-208, 222.

262. *Id.* at 228.

263. *Id.* at 220-221; see 51 Comp. Gen. 598 (1972) and 123 Cong. Rec. S9079-83 (daily ed. June 7, 1977); 55 Comp. Gen. 768 (1976).

264. Fenster and Volz, note 138 supra at 198.

265. *Blackhawk Heating and Plumbing Co. v. United States*, 622

F.2d 539, 552 n.9 (1980), citing *Berends v. Butz*, 357 F. Supp. 143, 156 (1973), in which the court noted that so long as the lump sum appropriation was not exceeded, reapportionments could always be sought by the agency, as well.

266. Fenster and Volz, note 138 supra at 206.

267. Id. at 204.

268. *Ivanhoe Irrigation Dist. v. McCracken*, 357 U.S. 275, 292-294 (1958); *Ex parte Endo*, 323 U.S. 283, 303 n.24 (1944); *Young v. Tennessee Valley Auth.*, 606 F.2d 143, 147 (1979); *Federation of Civic Associations v. Airis*, 391 F.2d 478, 482 (D.C. Cir. 1968). Cf. *United States v. Gila River Pima-Maricopa Indian Community*, 218 Ct. Cl. 74, 84 (1978).

269. See, e.g., DOD Appropriations Act, 1984, Pub. L. No. 98-212, § 750, December 8, 1983, 97 Stat. 1421, 1447.

270. 43 Op. Att'y Gen. 1, 5 (1980).

271. 55 Comp. Gen. 768 (1976). See GAO Report No. FGMSD-78-28 (B-132900), "Army Efforts To Restore Integrity To Its Financial Management System," April 27, 1978; GAO Report No. FGMSD-77-81, "Loss of Accounting Integrity In Air Force Procurement Appropriations," November 1, 1977.



272. 55 Comp. Gen. at 775.

273. Citing Consolidated Electrodynamic, ASBCA 6732, 63 BCA ¶ 3806 (1963)(reimbursement proper where Government (1) induced performance, (2) stated procurement urgent, (3) continued to administer contract, and (4) accepted the goods); Clevite Ordnance, Div. of Clevite Corp., ASBCA 5859, 62 BCA ¶ 3330 (1962); The Marquardt Corp., ASBCA 10154, 66-1 BCA ¶ 5576 (1966); American Machine and Foundry Co., ASBCA 8862, 65-1 BCA ¶ 4654 (1965). But cf. General Electric Co. v. United States, 412 F.2d 1215 (Ct. Cl. 1969); Engelhard Industries, Inc., ASBCA 11448, 68-1 BCA ¶ 6951 (1968); Pickard and Burns Electronics, ASBCA 12736, 68-2 BCA ¶ 7149 (1968).

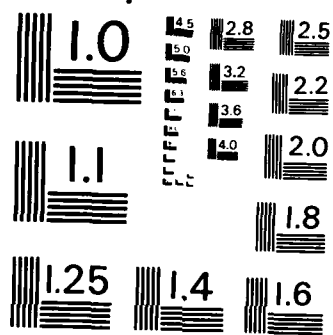
274. Citing only B-176498, October 2, 1973 (relief denied to pure volunteer where Limitation of Cost clause in contract).

275. Citing Porter v. United States, 496 F.2d 583, 590 (Ct. Cl. 355); Stewart Sand and Material Co. v. Southeast State Bank, 318 F.Supp. 870, 874 (D. Mo. 1970); Wells v. United States, 463 F.2d 434 (Ct. Cl. 1972); A. L. Coupe Const. Co., Inc. v. United States, 134 Ct. Cl. 392, cert. den., 352 U.S. 834 (1956).

276. 55 Comp. Gen at 778.

277. Id. at 774-775. See also 58 Comp. Gen. 46, 48 (1978).





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NATIONAL BUREAU OF STANDARDS - 1963 - A

**Chapter IV. Agency Efforts To Control Effects  
of Budgetary Restrictions on Programs**

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## Chapter IV. Agency Efforts To Control Effects of Budgetary Restrictions on Programs

Despite the prevalence of annual funding and annual contracting, federal agencies have a need to contract before appropriations. Agencies have evolved various contracting techniques to lessen the impacts on the formation and administration of contracts that implement their approved programs of statutory and regulatory fiscal control restraints -- these techniques are the subject of Chapter V. Chapter IV addresses the need to contract before appropriations, the origin and effect of the recent enhanced multiyear acquisition initiatives, and the question of when agencies might be liable to potential contractors who have expended resources on proposal or bid preparation to compete for insufficiently funded contracts.

### A. The Need to Contract Before Appropriations

Often sound business practice calls for contracts to be awarded for work to be done over more than one year.<sup>1</sup> For instance, service contracts can often be priced at lower costs if expenses of hiring and training personnel and transportation can be spread over several years; manufacturing contracts involving heavy start-up costs can be awarded at lower unit prices if costs can be spread out over more than

one year; and construction projects must be contracted over several years when they cannot be completed in one year. As Professors Nash and Cibinic observe:

[W]hile the obvious means of contracting in [these cases] . . . would appear to be to obtain appropriations covering several years effort, there are both legal and practical reasons why this practice is infrequently followed.<sup>2</sup>

The usefulness of Procurement titles' multiple year appropriations is chiefly limited by two policies. The first is the procurement full-funding policy. The second is the prevalent practice of annual funding. Annual funding is the Congress' practice of authorizing and appropriating only enough obligational authority to meet one year's requirements. This practice is seen as especially restrictive when understood in the context of the fiscal control laws and their applications -- some of which are described in Chapter III -- which are designed partly to restrict the use of government funds to only the purposes selected by the Congress.

While there is no legal reason why Congress could not authorize and appropriate funds covering more than one fiscal year's requirement (which might be called "multiyear funding"), there may be compelling political reasons why Congress chooses not to do so. There seem to be two chief reasons for this practice: (1) Congress apparently believes its control over the budget process would be lessened if

large, unexpended balances were left in the accounts of executive agencies, and (2) creating large amounts of standing multi-year budget authority would tend to lessen future congressional and executive freedom of action by permitting the formation of increasing numbers of multiyear contracts, with a concomitant rise in cancellation liability, and a requirement for bigger annual budgets.

While there is no Constitutional barrier preventing Congress from authorizing and appropriating funds to be available several years -- for at least two years or longer in the case of appropriations to equip the military services -- to do so restricts both program management flexibility and the degree of congressional control over administration activities achieved by frequent oversight reviews. However, this flexibility and control are not free -- in fact, they are achieved at a high price. The use of annual contracting is expensive directly because contractors must charge the government higher prices to compensate for the risk of losing work in subsequent years, and it is expensive indirectly because the inability to obligate funds in advance of their availability (except conditionally) disrupts the procurement process and prevents both the government and its contractors from always acting in the most economically rational ways.



Another indirect cost of the prevalent practice of annual contracting is that it may tend to reduce competition. When bidders must try to recover all their initial nonrecurring costs in the first contract period, or risk losing these costs should the contract be ended prematurely, some potential competitors will choose not to compete. Nevertheless, contracts will be let, to satisfy urgent government needs -- albeit at prices that might be higher than would have prevailed had there existed more competition -- to some of the contractors in the remaining, narrowed competitive field. Furthermore, these contractual relationships will tend to be self-perpetuating because, if the contracts run their terms and the need for those goods or services persists, the contracts will be recompeted and the incumbent contractors will enjoy the great advantage of having already recovered these initial costs, while remaining potential competitors will not have and will be at relative competitive disadvantages.

Annual contracting has some advantages, however, which have been seen as overwhelmingly important. Annual contracting does not burden future Congresses or administrations, and preserves their flexibility to effect design, production rate or quantity changes to respond to technological or threat changes, or to then-current economic or budgetary pressures.

When annual funds must be used, means other than forming multiyear obligations necessarily have been used to accommodate the need of contractors to recover heavy initial expenses, including paying much higher unit prices to permit amortization of these expenses within the first period (the only period for which the contractor can be assured of work), the use of capital investment incentives, or avoiding contractor incurrence of some of these expenses by providing government-owned plant or government-furnished equipment.<sup>3</sup> This Chapter focuses, not on these techniques, but on the reasons they have been needed and on recent initiatives to acquire enhanced multiyear procurement authority.

### **1. Restrictions on Annual Funds**

Congress generally appropriates funds for only one year's requirements. For example, of the funds made directly available to the Air Force in the FY 1984 DOD Appropriation Act -- not including retirement pay or amounts to pay claims -- the Military Personnel and Operation and Maintenance titles amounted to some 40 per cent of the total funds appropriated, consisting of annual funds. The Procurement and RDT&E appropriations, which are available for obligation for three and two years, respectively, amount to some 60 per cent. These two appropriation heads were no-year until changed in

the FY 1971 DOD Appropriation Act to reduce year-end unobligated balances and thereby increase congressional control.<sup>4</sup>

When time-limited annual funds or multiple-year funds are used, the antideficiency laws and the bona fide needs rule generally require obligation within the period of limitation to serve some legitimate needs for the period of limitation, within the time, purpose and amount limits of the funds' availability. When no-year appropriations are used the agency need only ensure that the government's obligation never exceed the funds made available for the purpose.

Agencies have sought to develop contracting techniques that allow them to purchase work for more than the current year, despite the fact that funds may be available for only the first year and, as noted in Chapter III, they have sometimes sought statutory authority to avoid the effect of the bona fide needs rule when time-limited appropriations are involved. The Comptroller has stated the limits on use of annual funds this way:

Contracts executed and supported under authority of fiscal year appropriations . . . can only be made within the period of their obligation availability and must concern a bona fide need arising within such fiscal availability. . . . Those contracts entered into under fiscal year appropriations purporting to bind the Government beyond the fiscal year involved must be construed as binding upon the

Government only to the end of the fiscal year. . . . Specific affirmative action by the Government, in effect making a new contract . . . , is required in order to extend the term of the contract beyond the fiscal year.<sup>5</sup>

But contracts can be made before funds are appropriated or administratively available. When annual funds must be used, contract awards can be made conditional on passage of the appropriation act funding the contract. When multiple-year or no-year funds or, presumably, contract authority can be used -- and, in DOD, when annual funds are used, at least for some services and associated supplies -- multiyear contracts can be formed. In these ways, contracts for future years' work can be conditioned on the availability of appropriations in those years. The use of multiyear contracting has been severely restricted, especially in agencies other than DOD, because the expense of its characteristic means of reducing contractor risk of loss of certain incurred but unrecovered costs -- the government's assumption of liability to pay certain charges in the event of premature termination or cancellation -- tends to reduce both program and budget flexibility.

Another limitation on the usefulness of multiyear contracts has been industry's reluctance to assume the perceived higher financial risks of large multiyear contracts, springing largely from the former \$5 million cancellation liability ceiling and the formerly-required exclusion of

recurring costs from the cancellation liability, as well as concerns over the greater risks of multiyear contractual periods associated with inflation, the high cost of financing (interest not being an allowable cost) coupled with low progress payment rates that in effect required a higher level of contractor financing, and rapidly-changing technology and agency requirements.<sup>6</sup> Also:

Industry claims that the present [Economic Price Adjustment (EPA)] clauses are inadequate for the relatively long time spans associated with [multiyear procurement (MYP)]. They advocate the adoption of a formula under which the government would provide at least some coverage of the risks that are clearly beyond the contractor's control, but over which the government can or does exercise some control. Examples cited most frequently by industry are (1) changes in federal or state tax laws, (2) changes in federal and state environmental control laws and regulations, (3) late and/or deficient government-furnished equipment (GFE), and (4) embargoes. Furthermore, to the extent that the contractor assumes increased financial risk under MYP, industry advocates special 'profit factor' considerations commensurate with that additional risk.

Industry also advocates inclusion of 'opportunity cost or lost profit' in the cancellation ceiling coverage. But since such factors are very difficult to measure objectively, it is highly unlikely that they would ever be covered.<sup>7</sup>

In addition, several other contracting techniques are available to accommodate the Congress' need for the flexibility and control of time-limited appropriations with the government's need to bind contractors to furnish goods and services even though adequate funds have not yet been

appropriated. The government and its contractors may:

-- Contract for the first period's needs, and agree upon priced options for succeeding periods' expected needs. This solution is often not fully satisfactory to either party: contractors still must bid high to attempt to recover their initial costs as quickly as possible because they cannot be assured of succeeding periods' work, and the government fails to achieve the lower unit costs that would be attainable if initial costs could be spread over longer periods. Options are commonly used in government contracting, but their use will not be examined in this thesis.

-- Use indefinite delivery contracting -- including the use of requirements, indefinite quantity and definite quantity contracts -- to bind contractors in advance of appropriations. These achieve flexibility by not binding the government, but still place the risks of uncertain work duration and quantity on contractors. Indefinite delivery contracting and related techniques are addressed in Chapter V.

## **2. Full Funding -- Incremental Funding**

Since the full funding policy is one of the two chief limitations on the usefulness of multiple-year procurement funds, the policy should be further examined. Further, it is

instructive to contrast the concept of full funding with the concept of incremental funding.

The full funding policy applies only to programs funded by the Procurement titles of the annual appropriations acts. Full funding is a requirement of OMB's Circular A-11 "Preparation and Submission of Annual Budget Estimates."<sup>8</sup> In DCI, this policy dramatically affects use of the Procurement appropriation:

In practice, it means that each annual appropriation request must contain the funds estimated to be required to cover the total cost to be incurred in completing delivery of a given quantity of usable end items, such as aircraft, missiles, ships, vehicles, ammunition and all other items of equipment."<sup>9</sup>

So, although supply or production procurement contracts must be fully funded under this policy, programs funded under other titles, such as the Military Personnel, and Operations and Maintenance appropriations -- not restricted by this policy -- could be funded incrementally. In fact, RDT&E programs commonly are funded incrementally.

In one case, this distinction between the availability of procurement and annual funds permitted a disappointed bidder to successfully protest both award to the apparent low bidder, and to prevent that bidder from modifying its bid to remain low under a proper IFB.<sup>10</sup> The agency's IFB was

structured to give weight to quantities which could not be purchased with available funds -- incremental funding was intended but since this was a supply (procurement) contract, incremental funding was not available. The apparent low bidder was prevented from modifying his bid to remain low, because it was low initially only because the IFB was improper. The protester would have been low bidder under a proper IFB, and to permit the apparent low bidder to change its bid would have permitted it to subvert advertised procurement policy.

The full funding policy applies to a procurement's starting point or original estimate: "It is recognized, of course, that estimates will change and that full funding of an item can exist only as of a point in time." <sup>11</sup> However, to ensure that the FYDP is a reliable statement of the expected cost of systems acquisitions, program estimates are kept current and fully financed through the PPBS process and reprogramming procedures. Before the initial obligation for each fiscal year procurement line item, Air Force program managers ensure that there is enough obligational authority to cover the estimated cost for that fiscal year.<sup>12</sup>

**a. DOD's Use of Full Funding**



DOD apparently uses the term "full funding" in a sense different from other agencies. DOD considers a program fully funded if funds are made available for all the costs associated with a single year's stated requirements of particular end items, while other agencies use the term full funding to mean providing for all the costs of entire programs.<sup>13</sup> The GAO's Glossary of Budget and Accounting Terms does not use "full funding" in the DOD sense, rather it states that full funding provides budgetary resources to cover the total cost of a program or project at the time it is undertaken, and defines anything less to be "incremental funding."<sup>14</sup> This disparity in usage raises a chance for misunderstanding by those unfamiliar with DOD's usage

because of the possibility that sequentially funded multiyear contracts may be viewed as suffering from the same problems that 'incrementally funded' procurements sometimes suffered from in the 1950s and early 1960s. Then funding-contracting arrangements often failed to provide for procurement of complete end items, and the Service (or Congress) sometimes had to choose between writing off an investment that had produced unfinished (and hence useless) items, or making additional resources available in the outyears to bring the unfinished items to completion. Such problems are not likely to arise today under the Defense Department's policy of end-cost full funding, but there is evidence to suggest that this point is still not as well understood as it might be, because of the conflicting definitions of incremental funding and full funding.<sup>15</sup>

To relieve this chance for misunderstanding, the use of the term "end-cost funding" has been suggested to describe

both usages:

Funding up front sufficient to cover payments for all the years of a multiyear contract is one type of 'full funding,' . . . . [I]t is convenient to describe such up-front funding as 'full-front funding.' In Department of Defense terminology, the term 'full funding' also refers to funding sufficient to cover the estimated costs of a single fiscal year's programmed requirement of end items, even if the future-year requirements in a contract are not yet funded. Thus a multiyear contract can be funded by a series of annual appropriation acts each of which provides 'full funding' for a single fiscal year's requirement. [One might] refer to such a funding arrangement as 'sequential full funding' or (briefly) 'sequential funding.' [The acronym SFMYC is therefore used to mean "sequentially full funded multiyear contract."] Both full front funding and sequential full funding provide for the full (estimated) cost of procuring a stated number of complete end items. They can thus be described as 'end-cost' funding. They should be distinguished from funding that merely supports on-going work but that does not provide for the production of complete end items; in Department of Defense usage, the latter type of funding is usually referred to as 'incremental funding.' Incremental funding is used for most RDT&E contracts, but is nowadays almost never used for the procurement of defense systems. For procurement, Department of Defense policy calls for full funding in the end-cost sense.<sup>16</sup>

Conceptually, full funding and incremental funding are at opposite ends a "fiscal risk" spectrum, where the risk compared is the possibility that some usable end items may not result from a program for want of funds. The policy of fully funding procurements aims to provide initially all funds necessary to secure part of a procurement program, stated as an annual "requirement" -- a stated number of complete, usable end-items. The technique of incremental funding provides full

initial authorization for a program but limits the government's liability to funds actually appropriated. Thus, incremental funding provides only enough funds to cover the costs of one year's progress with no assurance that any usable end-items will be delivered, unless the program is actually funded for each incremental period through the end of the program.

It is possible to conceive of a union of these funding concepts -- full funding initially of an entire procurement program with multi-year, multiple-year or no-year appropriations. While such a technique would permit maximum program certainty and stability, it might require the provision of much larger total obligational authority (TOA) in the years procurement programs were initiated -- although, conceivably, no larger outlays in any given program year -- and a greater perception of loss of congressional budget flexibility.

From the viewpoint of fiscal management, however, and particularly with the realities of interprogram budget competition and the need for cross-program, interyear budget flexibility in view, the full front funding of a major multiyear procurement could present serious problems:

1. It could require very large appropriations at the beginning of major-system procurement -- appropriations that the Congress might be reluctant to make.

2. If widely adopted for major systems, it could at the beginning greatly enlarge the 'bow wave' in the procurement appropriations accounts (the 'full funding bow wave'), and this might well be followed by an awkward series of sharp troughs and crests in subsequent budget requests and appropriations.

3. If such a contract were to be discontinued by the Government well before completion, this might create a large pool of appropriated funds for which no Congressionally authorized use existed.

4. Discontinuance might also involve quite large payments to the contractor to cover expenses incurred earlier in preparing for the production activity that was subsequently discontinued.

5. It would fence in funds, increasing the stability of the programs for which it was used by reducing year-to-year cross-program financial flexibility and thus probably decreasing the stability of programs funded annual or sequentially.

. . . .

The large appropriations at the beginning of a major-system procurement, and the initial full funding bow wave aggregated over all procurements, are often referred to as a principal objection to the full front funding approach to multiyear contracting. However, this objection may have been exaggerated. Conceivably, full funding might be achieved by means of 'advance appropriations' providing budget authority earmarked for a series of future fiscal years. In this way, the amounts for the future fiscal years would not be included in the budget totals for the initial fiscal year for which the appropriation act was passed. This might have the effect, however, of committing future Congresses. Another approach would be to introduce full front funding gradually while scheduling major-system acquisition milestones so as to distribute new production starts more evenly over the years. The latter step would probably involve difficult cross-program decisions, but these may be necessary in any case. . . .

It is also sometimes objected that full front funding of multiyear contracts would result in a bow wave of outlays as well as of appropriations. This might or might not be the result. Changes in the outlay schedule for a given procurement (that

is, changes from the schedule that would have prevailed with an annual contract or an SFMYC) would depend on the extent to which full front funding of the multiyear contract was accompanied by changes in the production schedule -- for example, an increase in production rate and an earlier completion of the total buy. Full front funding by itself need not imply any significant change in the schedule of outlays.<sup>17</sup>

In practice, of course, the government is seldom inflexibly committed to procurement: agencies enter into "unconditional" contracts in the sense that government contracts cannot unilaterally be changed or ended by the government. Government contracts generally contain termination for convenience clauses, and multiyear contracts also contain cancellation provisions, as explained more fully in Chapter V.

#### **b. Incremental Funding Contrasted**

Incremental funding is confusingly like the funding technique used with multiyear procurement. The primary distinction is that multiyear contracts provide for stated annual requirements of completed end items, like annual contracts but, unlike annual contracts, multiyear contracts provide for the needs of several years as stated in the FYDP. Multiyear contracts provide for government requirements for more than one, but fewer than five years. Funds are appropriated annually to cover such contracts' costs for the next budget year with the contractor being protected against

loss of nonrecurring initial costs should a premature cancellation occur, by contractual entitlement to recovery up to a statutory cancellation ceiling. Formerly, the practice was that funds were generally not committed or obligated to cover the contingent liability of cancellation costs. With major acquisition programs, the potential cancellation liability can be very large. There have been efforts in recent years to break away from the restraints of annual contracting where significant cost savings could be realized by longer-term commitments.

As discussed in Chapter V, incrementally funded contracts contain clauses limiting the government's obligation to funds appropriated and available. If terminated due to unavailability of funds, a contractor's duty would be to deliver any end items completed, and any unused parts and unfinished materials acquired under the contract. Because future years' appropriations are required to complete end items and the contractor generally has no obligation to deliver any completed end items, unless later years' funds are furnished by later Congresses, incremental funding might be characterized as a funding technique for buying "parts of end items."

Incrementally funded contracts would tend to commit a future Congress to programs selected by an earlier Congress by

requiring future appropriations. Future Congresses would have to provide more appropriations to avoid wasting earlier appropriations to bring programs fully authorized but incompletely funded by the earlier Congress to bring the programs to fruition. In incremental funding, budget authority is provided for only a portion of the total estimated obligations needed to complete a program -- those expected to be incurred in a single fiscal year, and only enough funds to satisfy that year's obligations are provided.<sup>18</sup> This is often called "spoon feeding." Incremental funding has the advantage of leaving low levels of unobligated balances at the ends of fiscal years and, thus, of requiring smaller annual provisions of TOA.

The full funding policy tends to limit the numbers of end items to which the government can commit itself at any given point in a procurement, producing substantial uncertainty (especially in the case of major weapons systems requiring high initial contractor investment) concerning the duration and extent of government procurement programs. This uncertainty produces higher unit costs, especially in firm contracts for end items with stable designs. The wisdom of annual funding and annual contracting is often questioned. For example:

[T]he time necessary to conduct research, development and quantity production of major weapon systems has increased dramatically. It is no longer possible, if it ever was, to change direction drastically on a major weapons program. . . . As a result, the annual question is not whether to purchase [a particular] aircraft, but rather will the United States buy 96 or 108. Unfortunately, the entire planning, programming and budgeting process and the resulting contractual arrangements are based upon the annual buy concept which permits Congress to revisit the . . . program every year. The cost of maintaining flexibility to stop a program and receive [some] completed end items is enormous, especially when it is not needed because, as a general rule, the only changes made are slight variations in quantity.<sup>19</sup>

### c. Advantages of Full Funding

Annual contracting thus maintains maximum congressional program control through the authorization and appropriation process. Full funding tends to support this policy of flexibility by requiring full initial disclosure of estimated program costs and requiring the then-current Congress to authorize and appropriate sufficient funds to pay the whole cost of approved requirements. Full Funding requires programming, budgeting and making available enough funds in the first year to cover the estimated total cost of stated annual "requirements" of a completed procurement program, including any necessary support equipment, technical data, incentive fees, economic price adjustments and spare parts. The policy of fully funding procurements tends to provide more complete cost data on procurement programs to the Congress and to the public, and it also ensures that delivery



of usable end items will not be dependent on future years appropriations.

However, full funding does permit programming, budgeting and funding some necessary items in advance, such as major components or support equipment. Advance procurement (sometimes called "advance buys") for long lead time components is authorized in the Aircraft and Missile Procurement appropriations when such items must be procured in the fiscal year ahead to meet programmed end item manufacturing schedules. Advance procurement is limited to components with significantly longer leadtimes than the basic systems into which they will be integrated (such as engines, wheels and brakes for aircraft end items). The cost of the long leadtime items is budgeted and funded in the year these items are procured, not in the year the end item will be delivered, but the use of advance procurement ultimately reduces the total obligational authority available to the fully funded program.<sup>20</sup>

#### **d. Comptroller's View of Full Funding**

The Comptroller supports the full funding policy:

[W]e said that congressional and executive "full-funding" budget action on programs and activities with multiyear commitments was a sound budgetary policy and procedure. The full-funding

concept entails the provision of funds at the outset for the total estimated cost of a given item. This practice gives the Congress and the public knowledge of the full dimensions and costs of any item when it is first presented for funding. We believe this knowledge facilitates congressional decision-making with respect to funding priorities within the budget year spending ceiling. Programs compete on a more equitable basis under the full-funding concept since it emphasizes the full Federal investment involved in each new start. Incrementally funded multiyear programs enjoy an advantage in competing for dollars in that only a portion of their total cost is requested each year. The fact remains, however, that once a commitment is made, the federal Government may find it difficult to terminate the project. Therefore, full funding would increase Congress' initial control and oversight over total spending and outlays in future years. We feel that this is one of the primary objectives of the Congressional Budget and Impoundment Control Act of 1974. . . .

We recognize, however, that providing budget authority for full program costs in 1 year would require a higher budget authority ceiling in the concurrent resolutions on the budget than would currently be required by providing budget authority for partial costs for the same programs under incremental funding. In short, the political realities of implementing the full-funding concept Government may be difficult to accept.<sup>21</sup>

However, in the Comptroller's view, there seems no doubt that agency departure from the full funding policy -- while undesirable -- is not in itself a 31 U.S.C. § 1341 (a) or a 41 U.S.C. § 11 violation. Perhaps the best illustration is the Newport News Shipbuilding and Dry Dock Co. decision.<sup>22</sup>

In determining whether the Navy's exercise of an option for another nuclear powered guided missile frigate (DLGN 41) was proper, the Comptroller distinguished between

the full funding policy and the Antideficiency Act. He pointed out that the full funding policy is not statutorily required for military procurement programs in which

funding for those programs is requested and provided at their initial stage on the basis of the entire estimated cost of the procurement regardless of the the anticipated fiscal year timing and rate of obligations.<sup>23</sup>

Further, he noted that the policy does not require all contractual activities in which performance stretches over several years to be fully funded:

[R]esearch and development programs are funded 'incrementally,' that is, appropriations are requested and provided in fiscal year installments limited in amounts to the anticipated obligations necessary during particular fiscal years.<sup>24</sup>

Like reprogramming, DOD's full funding rules are stated as a formal directive, the content of which has been evolved between DOD and congressional committees and, as in the case of violation of the DOD reprogramming directive, the Comptroller approved the Navy's option exercise for the frigate even though it violated the principle of full funding because the entire program initially authorized could not be completed with available funds.

[P]rocurements for certain program elements might still be capable of completion within the limits of appropriations now available, although the total cost of the entire program is not fully funded under

current estimates.<sup>25</sup>

However, the Antideficiency Act would be violated if the government's actual obligation under this contract exceeded funds then actually available.

To determine the issue of whether the DLGN option was a lawful obligation or created an Antideficiency Act violation, the Comptroller determined if the option could be exercised under the then-current estimates within the appropriations available. He agreed that a lump-sum appropriation was not restricted by its legislative history because not expressly carried over into the appropriation act itself, giving the Navy currently-available appropriations of \$360 million. From this, the Comptroller subtracted the target price, escalation costs, amounts obligated to other contractors on the same ship, and sums already obligated for authorized advance procurement for the next DLGN, leaving about \$100 million. Whether an overobligation existed was determined by the wording of the Navy's contractual obligation to provide certain government-furnished property (GFP).

Since the expected cost of the GFP on the contract would be \$166.1 million, and the \$58.55 million obligated for other contractors was to acquire some of the GFP, this left a \$107.55 million GFP obligation outstanding to be covered by a remaining appropriation of about \$100 million. There would be

a \$7.5 million deficiency -- and an antideficiency act violation -- if the Navy was contractually obligated to furnish all the expected GFP. However, since the contract reserved in the Navy a unilateral right to decrease or substitute the GFP enumerated, the Comptroller was unwilling to find an Antideficiency Act violation:

While it remains possible that future actions by the Navy with respect to GFP might result in sufficient obligations or other Government liability so as to be objectionable under 31 U.S.C. § [1341(a)] or 41 U.S.C. § 11, we cannot conclude that such obligations or other liability existed at the time of the exercise of the option.<sup>26</sup>

#### **e. Full Funding and Cost Estimates**

It is thought that full funding makes fiscal control easier, because incrementally funded programs may be embarked upon without full realization of the costs involved. This objection seems premised entirely upon the assumption that cost estimates on which full funding projections are based are sufficiently accurate to provide such notice. However, unrealistically low initial cost estimates have long been recognized as endemic to government procurement.<sup>27</sup> This has been attributed partly to the conjoining effects of the differing incentives the system places on the participants: competitors tend to bid low to increase their chances of winning the contract, and the government tends to estimate low to secure initial congressional and public acceptance of a

desired program. The recent requirement for independent cost estimates for major acquisition programs should mitigate this problem.<sup>28</sup> Of course, there are other influences on cost growth: inflation, delay costs, and changes in requirements including quantity, schedule and specifications.<sup>29</sup>

It has been observed that government procurement officials tend to believe that a low initial cost estimate coupled with a grudging government attitude toward adding funds is the best way to control final cost in a procurement system with so many variable factors. Still, it has been argued that this belief is wrong and that, in fact, low initial funding can cause program delays through funding shortfalls, as well as counterproductive contractor and subcontractor engineering and production shortcuts that culminate in costly systems that are difficult to operate and expensive to maintain. It has been suggested that some too-low proposals could be avoided if Source Selection Evaluation Boards were instructed to choose the most competent source below a given price threshold, rather than encouraged to select the least costly source above some competence threshold. Alternatively, it has been suggested that the government might acknowledge the unreliability of some initial cost estimates, and refrain from setting firm target costs until a year or so after development has been underway when development and production design problems should be better

understood.<sup>30</sup>

It would seem that the way to achieve the firmest basis for choosing the contracting/funding combination most advantageous to the government would be to compare simultaneous offers on the same work predicated on various alternatives. This would impose substantially greater proposal preparation costs on offerors.<sup>31</sup> In fact, this is the prescribed practice for multiyear solicitations, although it is recognized in the FAR that requiring dual annual and multiyear offers sometimes may be counterproductive:

[T]he preparation and evaluation of dual proposals may increase administrative costs and workloads for both offerors and the Government, especially for large or complex acquisitions. The head of a contracting activity or a designee may authorize the use of an Invitation for Bid (IFB) or a Request for Proposal (RFP) requesting only multiyear prices in a solicitation, provided it is found that such a solicitation is in the Government's interest, and that dual proposals are not necessary to meet [multiyear contracting] objectives. . . .<sup>32</sup>

Alternatively, the choice could be based on government price estimates, compared to contractor estimates.

### **3. Research and Development Funding**

In contrast to production contracts, research and development contracts are generally programmed and budgeted

incrementally, rather than fully funded. An annual increment for an RDT&E program element or project includes only the obligational authority needed to cover all costs during that increment. Research and Development activities are incrementally funded because their progress is uncertain and their outcome cannot be determined in advance -- so only enough funds to pursue the research phase in progress will be provided. In 1971, the Senate Armed Services Committee suggested principles for incrementally funding RDT&E programs, with a view to standardizing the practices of the services.<sup>33</sup>

These principles established a 12-month standard period, except when the effort cannot be subdivided into 12-month segments, or when no responsible contractor will accept a 12-month period. In no case was the period to exceed 18 months. Where multiyear contracts were used, still the initial period was to be 12 months beginning with the fiscal year, when major weapon systems were involved. Defense research sciences programs with educational institutions could be initially funded up to 36 months, with renewal increments no greater than 12 months. Operation and maintenance RDT&E "in-house" costs were to be programmed and funded on an annual basis which need not be coincident with the fiscal year. In the Air Force, this results in two-year RDT&E funds being divided into two components to support the mission program and the management and support program. The management and



support program is treated essentially as an annual appropriation and the general rule for use of the mission program component is to treat it as if available for obligation only in the first year of availability.<sup>34</sup>

Although RDT&E funds are not normally used to buy efforts beyond the year of the appropriation, when current year funds are used to purchase goods or services in future years the practice was formerly called "forward financing," and is now referred to as a deviation from the incremental programming policy applied to the RDT&E appropriation.<sup>35</sup>

As weapons systems progress through the research and development phase, they are tested and evaluated to prove their suitability and effectiveness under operational conditions. Generally, in the initial phase of Operational Test and Evaluation (IOT&E) both the test articles and test support are financed with RDT&E funds, and the follow-on phase (FOT&E) is funded with the Operation and Maintenance appropriation.<sup>36</sup>

#### **B. Recent Multiyear Procurement Initiative**

Congress has been slow to accept proposed "advanced competitive strategies" requiring higher initial expenses to secure future benefits, including improved system

dependability, maintainability and lower system cost. Politically, there are substantial pressures to maintain both maximum program flexibility and low apparent program cost, certainly for the expensive major systems acquisitions. Flexibility has been called the hallmark of our system of "political competition," in which "factors other than price and system design and performance help decide what is to be built." Political competition is thought to result from Congress' use of government procurement as a tool to achieve fiscal, labor and social engineering policies and its desire to prevent loss of major defense contractors.<sup>37</sup> Congressional eagerness to embrace apparent lower front end costs has been attributed also to awareness that high short term costs arm political opponents with arguments not easily dispelled by appeals to expected, but as yet unrealized, long-term savings.<sup>38</sup>

### **1. Multiyear Procurement Initiative History**

The recent history of multiyear contracting is complex:

During the 1960s [sequentially full funded multiyear contracts (SFMYC's)] were one of the funding contracting modes routinely available if not typically used in system procurement. Later, restrictions on SFMYC use were introduced partly because of disillusionment with Total Package Procurement (which had often used SFMYCs), and partly because of Congress' desire to avoid the

large cancellation charges that, under previous rules, could become payable if major-system SFMYCs were to be canceled. When cancellation of a Navy SFMYC for helicopter carriers generated a contractor's claim for \$110 million, the House Armed Services Committee objected that contracts allowing such cancellation claims could bind the Government to pay huge sums for which appropriations had not been made. As a result, in the FY 1973 defense authorization, the Congress imposed a ceiling of \$1 million on the cancellation charges allowable in future SFMYCs.

Although Congress increased the maximum cancellation charge to \$5 million three years later, the limit was still so low that it ruled out SFMYCs for the production of major defense systems; \$5 million was almost always too little -- usually far too little -- to cover the expenses of a contractor incurred in preparing for future-year production of major hardware items. The risk of cancellation with the resulting loss due to unreimbursed expenses was too great for contractors to accept.

. . . .

Recently, however, interest in multiyear procurement has revived, and proposals have been made for the expanded use of SFMYCs, especially for the procurement of hardware items of high unit or total program costs such as aircraft or missiles, where the use of SFMYCs has been most severely constrained by statute and regulation. The General Accounting Office and the Defense Science Board reported in its favor. The Panel on Industrial Preparedness of the House Armed Services Committee held extensive hearing during which General Alton D. Slay (then Commander of the Air Force Systems Command) and a large group of industrial leaders unanimously recommended the increased use of SFMYCs, a recommendation the Panel strongly endorsed in its own report. Subsequently, defense authorization bills in both the House and the Senate included words aimed at reducing the restrictions on SFMYCs and encouraging their greater use. These bills were supported by Secretary of Defense Caspar W. Weinberger, who, with Deputy Secretary Frank C. Carlucci and Under Secretary Richard D. DeLauer, adopted multiyear procurement as one of the major Department of Defense initiatives for improving the acquisition process. When [this quoted RAND Note] was first drafted, the House and Senate

authorization bills had just been passed by their respective houses and differences were being reconciled by the House-Senate committee of conference. The conference report favored the House position on SFMYCs, giving strong support for the expanded use such contracts and raising the cancellation ceiling to \$100 million. The Department of Defense Authorization Act, 1982, which embodied this provision, has just become law. It appears likely, therefore, that SFMYCs will be adopted in the future for an increased share of defense procurements, including the procurement of some major systems.<sup>39</sup>

One major objective of these recently-proposed "advanced contracting techniques" was to produce greater program certainty and stability to reduce unit costs. Government contracts are regarded as less dependable than commercial contracts partly because fiscal law restraints usually compel limiting their duration to one year, and partly because the government retains the unilateral right to change item characteristics, quantities, production rates, or even to terminate or cancel the contract altogether.<sup>40</sup>

DOD recently proposed -- and in the FY 1982 DOD authorization act the Congress largely permitted -- expanded use of multiyear contracting and incremental funding to secure stability benefits in economic term contracts, a term intended to include expanded multiyear contracts, incrementally funded production contracts and block buys. It was proposed that advance procurement authority be expanded to permit economic lots of materials in which block buys would be used to purchase more than one year's requirements in a single year's

contract, although the contract might be incrementally funded by providing only one year's funds. Incrementally funded production contracts have been precluded by the full funding policy. Because these proposals ran afoul of the bona fide needs rule, some form of statutory contract authority or multiyear authorization and appropriation would be required to authorize obligating the government beyond the funded period established by the appropriations, even though less than the total projected costs of a program need necessarily be appropriated for each year. Of course, future year appropriations would be needed to secure all the planned end items.

Fixed price contracts apparently have not been commonly incrementally funded, neither under the DAR, FPR, nor the FAR.<sup>41</sup> NASA permitted unrestricted use of Limitation of Funds (LOF) clauses in cost-type R&D contracts, but required certain time, amount and funding limitation criteria be met before authorizing use of LOF clauses in either cost-type supply or fixed price R&D contracts. NASA's comment on the Phase I FAR 32.704-1 (b), which would have permitted LOF clauses to be used with fixed price contracts is instructive:

These controls of management were deliberately established in order to restrict use of the NASA clause. Our basic concern is that, without control at Headquarters level, the Limitation of Funds clause would be indiscriminately used in cost-type supply and fixed-price contracts. Our experience

with requests for deviation supports this view, since we still receive requests to use the clause in contracts for small dollar amounts, which should unquestionably be fully-funded from the start. Through the use of the Limitation of Funds clause on cost-type contracts, we have already 'mortgaged' a large portion of future years' funds. The elimination of the current restrictions would further restrain NASA management's flexibility in the handling of future appropriations. This, for all practical purposes, would remove the concept of 'full funding' on fixed-price contracts. We believe that other federal agencies would also desire to have similar controls over the use of the Limitation of Funds clause, rather than find themselves in a 'buy now -- pay later' posture.<sup>42</sup>

Proposed expanded multiyear contracts would permit more flexibility than available under the DAR 1-322 standards. Under the DAR multiyear contract, no more than five years' requirements could be bought and each program year is budgeted and funded annually -- at the time of award, only the first year's funds need have been appropriated. The contractor was protected against loss of nonrecurring initial costs, should the contract be cancelled, up to the statutorily-limited cancellation ceiling of \$5 million. The DAR multiyear contract also was required to be either firm fixed price or fixed price with economic price adjustment terms. Expanded multiyear contracts would be designed to achieve greater economies of scale by providing either full or incremental funding, and higher cancellation ceilings, economic price adjustment or progress payment provisions. Such "economic term contracts" were proposed for use where the requirement, the funding level, and the design were stable, and where the

economic term contract would be less expensive than annual or standard multiyear alternatives, considering each alternative's perceived risks.<sup>43</sup>

The wider use of multiyear contracting was sought to secure the benefits of lower procurement unit prices, increased industrial productivity through encouraging plant investments, and broadening of the defense industrial base.

It was argued that, while restricting contracts with durations greater than one year preserves congressional flexibility, it does so at great cost. Permitting more stable, longer contracts might achieve great cost savings. Short duration contracts generally are characterized by high unit costs, while longer, more stable contracts could achieve lower unit costs subject to the risks that either program changes or termination/cancellation charges might raise contract costs to the point that the expected savings might ultimately be reduced or exceeded.

The basic policy choice is between stability and flexibility: from the government's perspective, preserving maximum program management flexibility is expensive while stability is often perceived as politically and economically risky.<sup>44</sup> The economic risks of stability may be lower than commonly believed, however. It was argued that while there

would appear to be a greater chance that some long term contracts might need to be cancelled as government needs change, short term contracts actually cost more per unit -- while cancellation liability was formerly merely contingent.

There is a compelling argument why cancellation liability should not be funded:

It might appear that an unfunded cancellation liability would carry a greater risk due to the potential impact on funds for other DOD or Government programs if cancellation occurs. Such cancellation impacts would result from intradepartmental reprogramming or a supplemental appropriation (which would result in increased Treasury interest payments or a failure to fund/continue to fund other programs). However, funding the cancellation liability does not reduce risk. By funding the liability, the Government has incurred opportunity and/or interest costs, only at an earlier time. The contingent liability created by unfunded cancellation costs would appear to be an acceptable risk based on the history of no known cancellations of major weapon systems productions programs.<sup>45</sup>

Very different contract prices could be expected to result from different combinations of contract type with different funding arrangements, precisely because risk of cancellation is expressly or implicitly allocated differently and because more economic operations are either encouraged or prevented. Annual contracting, for example, gives contractors no assurance of any future work. Annual contracting produces the highest unit prices. Contractors must attempt to recover all their costs in the first contract period, because they



have no contractual right either to future work over which such costs might be spread or to cancellation charges.

On the other hand, multiyear contracting could produce lower contract prices, although at the expense of express government assumption of cancellation liability for at least nonrecurring costs, up to the statutory cancellation ceiling. This cancellation liability would decline each year, as each year's increment of units was ordered, increasing the base over which nonrecurring costs can be spread. Unit nonrecurring costs can be calculated by dividing the total nonrecurring costs by the total multiyear quantity. Remaining cancellation liability may be figured by multiplying unit nonrecurring costs by the number of units remaining to be procured in out-years. For example, if 1000 units are expected to be ordered in a 3-year multiyear contract -- 100 the first year, 500 the second, 400 the third -- and total nonrecurring costs are \$500,000, the unit nonrecurring cost is \$500. Total cancellation liability would be \$500,000 the first year, \$450,000 the second and nothing the third (because ending the contract within the last year would be a termination and not a cancellation, which would be settled under the termination for convenience clause).

It was also argued that further savings over the high cost of annual contracting could be realized if techniques

such as advance procurement of long leadtime components or of economic buys of materials in preceding fiscal years could be authorized. Still lower prices could be achieved if recurring costs also could be guaranteed with the cancellation liability.

For example, one of the foremost advocates of enhanced multiyear contracting commented:

Another significant benefit of multiyear procurement is stability. It allows contractors to purchase raw materials and components in larger, more economical lot quantities, which in turn results in significantly lower prices. To date, our experience indicates that the major portion of saving obtained under multiyear procurement can be attributed to more efficient material purchases; however, work force stability is also an advantage. Perhaps the most important long-range benefit of multiyear procurement is that it encourages contractors to increase their capital investment. Long-term, stable requirements provide better opportunities for recovering investment costs. They also allow contractors to obtain more favorable loan terms and to spread the cost of productivity enhancements over a larger base.<sup>46</sup>

Thus, there are advantages and disadvantages associated with the different funding/contract type alternatives. Full initial funding and annual contracting produces maximum program management flexibility at the highest cost -- and this high cost tends to reduce the goods and services which may be acquired with scarce defense dollars. Multiyear contracts hold the promise of lower contracts prices, but at the expense of the assumption of cancellation

liabilities. Incremental funding, with Limitation of Funds clauses, requires the lowest provision of funds each year but also gives contractors no assurance of future funding, and gives the government no assurance of any completed end items without authorizing and funding future years' work. Multiyear funding -- congressional authorization and appropriation for more than one year's requirements -- gives maximal stability at the expense of program diversity and flexibility. There seems little chance that the Congress will adopt multiyear funding:

[I]ndeed, during recent years the Electronics Industries Association, as well as some high-level officials from major defense contractors, have been lobbying for multiyear funding. Even GAO in 1979 supported this concept for major weapon systems acquisition, and in a 1981 report widened that support to R&D.

Although the Defense Science Board (DSB) in 1979 advocated multiyear funding, it backed away from the concept in 1960 on the grounds that MYF would 'exacerbate the current "bow wave" problem' in funding, and advocated instead the use of enhanced multiyear procurement. Recently, industry has also backed off from multiyear funding and adopted enhanced multiyear procurement as a fall-back position, chiefly because of the realization that Congress is highly unlikely to approve multiyear funding in the foreseeable future and that enhanced multiyear procurement (with a high cancellation ceiling) can accomplish almost as much as multiyear funding.<sup>47</sup>

## **2. DOD's Enlarged Multiyear Procurement Authority**

These proposed enhanced multiyear contracting improvements were in fact largely enabled for DOD (but not for other agencies) by Section 909 of the FY 1982 DOD authorization act,<sup>48</sup> which (1) raised the cancellation ceiling from \$5 million to \$100 million, with higher ceilings permitted after notice to both Houses' Armed Services and Appropriation committees 30 days prior to contract award; (2) permitted the inclusion of recurring costs in cancellation ceilings; (3) provided for economic lot buys; (4) allowed advance procurement of both long leadtime components and economic order quantities to achieve economic lot purchases and more efficient production rates; and (5) broadens DOD's authority (but specifically excludes NASA and the Coast Guard) under 10 U.S.C. § 2306 (g) to purchase services with annual funds ("funds . . . otherwise available for obligation only within the fiscal year for which appropriated") within the United States, now, as well as outside the United States, and adding a new Section 2306 (h) to purchase property, "including weapon systems and items and services associated with weapons systems (or the logistic support thereof)," "to the extent that funds are otherwise available for obligation."

This specific statutory authority to engage in multiyear contracting for property is subject to a finding by the agency head:

(A) that the use of such a 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.<sup>49</sup>

These congressional criteria emphasize cost reduction, and emphasize the recurring congressional concern with cost estimate realism, as well as the prudence of restricting multiyear obligations to established production operations with low technological risk. They are demanding criteria, and few proposed procurements should be expected to satisfy them.<sup>50</sup> To the extent that similar procurements could have been achieved by administratively expanding the concept of advance procurement, these statutory restrictions might be viewed as unnecessary burdens. However, they correspond to those used by DOD, basically a benefit/risk analysis in which the benefits to the government, generally cost reduction, are balanced against five risk factors: the degree of confidence

in the cost avoidance estimate, the degree of confidence in the contractor's capability; and three criteria relating to program stability, stability of requirements, stability of funding and stability of design.<sup>51</sup>

The amended 10 U.S.C. § 2301 seems a ringing endorsement of the enhanced multiyear procurement proposals:

§ 2301. Declaration of Policy

(a)(1) The Congress finds that in order to ensure national defense preparedness, to conserve fiscal resources, and to enhance defense production capability, it is in the interest of the United States to acquire property and services for the Department of Defense in the most timely, economic, and efficient manner. It is therefore the policy of the Congress that services and property (including weapon systems and associated items) for the Department of Defense be acquired by any kind of contract, other than cost-plus-a-percentage-of-cost contracts, but including multiyear contracts, that will promote the interest of the United States. Further, it is the policy of the Congress that such contracts, when practicable, provide for the purchase of property at times and in quantities that will result in reduced costs to the Government and provide incentives to contractors to improve productivity through investment in capital facilities, equipment, and advanced technology.

(2) It is also the policy of the Congress that contracts for advance procurement of components, parts, and materials necessary for manufacture or for logistics support of a weapon system should, if feasible and practicable, be entered into in a manner to achieve economic-lot purchases and more efficient production rates.

However, the congressional practice since has tended to narrowly restrict the use of this enlarged authority. For

example, Section 760 of the FY 1984 DOD appropriations act states:

None of the funds provided in this Act shall be available to initiate (1) a multiyear contract that employs economic order quantity procurement in excess of \$20,000,000 in any one year of the contract or that includes an unfunded contingent liability in excess of \$20,000,000 or (2) a contract for advance procurement leading to a multiyear contract that employs economic order quantity procurement in excess of \$20,000,000 in any one year, unless the Committee on Appropriations and Armed Service of the Senate and House of Representatives have been notified at least thirty days in advance of the proposed contract award. Provided, That no part of any appropriation contained in this Act shall be available to initiate multiyear procurement contracts for major systems unless specifically provided herein. For purposes of this provision, a major system is defined as a system or major assembly thereof whose eventual total expenditure for research, development, test and evaluation is more than \$200,000,000 or whose eventual total expenditure for procurement is more than \$1,000,000,000.<sup>52</sup>

Agencies also bear the burdens of justifying their proposed multiyear procurements in their budget estimate submissions and, additionally, multiyear procurements of major weapons systems may not be undertaken unless specifically provided in the DOD appropriations act, after specific justification to the oversight committees.<sup>53</sup>

In fact, in the fiscal years 1982-1984, DOD submitted 36 multiyear procurement candidates to the Congress, of which 21 were approved. DOD estimates net savings for these programs at \$3.4 billion through FY 1983.<sup>54</sup>

Clearly, these changes in DOD's multiyear contracting authority have sought a redistribution of the financial risk of outyear advance procurements and multiyear contracts. It is now possible for the government to require purchases of economic order quantities that formerly only could be achieved, if at all, by the contractor voluntarily assuming the risk of loss in the event of program cancellation. It is now also possible to include the contractor's unamortized recurring costs in the cancellation liability, even though this liability must be funded, unlike unamortized nonrecurring costs which continue to be treated as unfunded contingent liabilities. These changes should modify the way DOD does business, in time:

Today defense procurement obligations are characterized by a high percentage of full funding and a modest (though increasing) element of advance procurement (that is, procurement of items other than complete end items). In the future, unfunded liabilities and liabilities for non-end items can be expected to increase, perhaps only modestly but perhaps dramatically. A careful risk assessment will be needed.

New and multiple objectives can be pursued. Previously, as just discussed, advance procurement was authorized only as a means of shortening the period required to obtain complete end items. With the new legislation, this method of contracting can be used for objectives as diverse as inflation avoidance in procuring raw materials, establishing efficient production rates, and strengthening the lower tiers of the industrial base. In the 1970s, the principal objective of the multiyear procedure, according to the 1976 edition of the DAR, was 'to generate realistic competition by minimizing



competitive disadvantage' among contractors. Today, the DOD Authorization Act, 1982, emphasizes reduced costs to the Government through incentives for contractors to increase productivity by investing in new plant and using new technology.<sup>55</sup>

Despite the enlarged multiyear contracting authority given DOD, major fiscal issues remain that go to the heart of the usefulness of this greater authority. As noted in Chapter V, DOD has not rushed to include recurring costs in the cancellation liability, and the credibility of DOD's cost estimating remains a perennial issue, as does the persistent doubt whether widespread use of multiyear contracting really would promote or inhibit competition:<sup>56</sup>

The reason for uncertainty about the effect of multiyear contracting on competition is that two opposing factors are at work: (1) the size of the contract and (2) the frequency of contract awards. Different conclusions can be reached depending on which of these factors is emphasized.

Multiyear contracts would normally be substantially larger than annual contracts and therefore presumably more attractive to prospective producers; the larger contracts might stimulate additional firms to bid as well as more aggressive bidding among the firms that do compete. Furthermore, even when one producer already has the advantage of accumulated experience in producing the item, a follow-on multiyear contract (unlike an annual contract) might call for production quantities large enough that new producers could hope to overcome the first producer's advantage from being 'farther out' on the cost-quantity curve.

With multiyear contracting, however, there are fewer contracts to be awarded, hence fewer opportunities for competition. The multiyear contract may thus 'lock out' contractors who might have competed later on if procurement had been conducted by means of a series of annual contracts.

This point is made by some industry representatives. To it there are several replies. From the buyer's viewpoint, the significant thing is not the number of opportunities for producers to compete for contract awards. Rather, it is the strength of the the producers' incentives to compete, the number of qualified competitors and the intensity of the competition when there is an award to be made -- all of which may well be enhanced by the greater size of the multiyear buy. Moreover, although prospective suppliers may be 'locked out' by multiyear contracts, the winner of the award is 'locked in,' often to the buyer's advantage. If the multiyear contract is awarded on a competitive basis, the whole of the multiyear buy is procured at competitive pricing, whereas under annual contracting the awards for the second and subsequent years are often de facto sole source, with the first-year producer then exploiting his sole-source position and selling at prices higher than he could otherwise demand.

More experience and study are needed before these counter-arguments can be weighed and the effect of multiyear contracting on competition adequately understood. In any case, however, there are likely to be few opportunities for competition among prime contractors for the production of major systems. For a major system there is normally only one developer and hence only one qualified producer. With or without multiyear contracting, price competition among producers can be expected to be limited mainly to subcontractors and to the prime contractors of nonmajor systems.

One continuing issue resides in savings calculation. Not only the firmness of cost estimates on which savings are based has been drawn into question, but whether savings should include such components as escalation avoidance or such factors as improving the productivity of the defense industrial base which are inherently hard to quantify. There also is a continuing controversy concerning whether and how to discount the relative costs of multiyear contracting when

compared to annual contracting alternatives to adjust for the faster rate of actual expenditures associated with multiyear procurement.<sup>58</sup>

### 3. Multiyear Contract Cancellation Liability Funding

In particular, the issue of how much of the potential cancellation liability must be funded (i.e., obligated, thereby absorbing TOA) and how much may remain an unfunded contingent liability strikes to the core of the viability multiyear contracting. Since most of the cost savings of multiyear contracting spring from first-year obligations for long leadtime items and economic order quantities of components, parts and materials expected to be needed in future years, there is a proportional relationship between the size of cost savings and the size of potential cancellation liability.

The congressional appropriations committees, OMB, and the DOD financial communities favor a full-funding policy. The congressional attitude stems primarily from a reluctance on the part of each Congress to create unfunded liabilities that have the effect of tying the hands of future Congresses and administrations by committing them to either appropriating money for large cancellation charges required to end some of those programs, or continuing the funding of programs they might otherwise not want. Another factor contributing to congressional preference for full funding has to do with oversight. In the last decade or so the Armed Services and Appropriation Committees of both houses have acquired very tight control over weapons systems acquisition. There is congressional concern

that relaxation of the full-funding policy would lead to reduced cost visibility and hence to a weakening of congressional control or oversight.

The basic objection of OMB and the DOD financial communities to relaxing the full-funding policy stems from concern that a practice of obligating funds that are not available at obligation time will in some cases ultimately lead to violations of the Antideficiency Act. [This seems to reflect either the position that only overexpenditures violate the antideficiency act, or a confusion of unfunded contingent obligations with actual obligations.]

There is also the underlying concern here that [multiyear procurement], in conjunction with a relaxation of the full-funding policy, would reduce the flexibility of both Congress and the Secretary of Defense in responding to unforeseen changes in threat, as well as to breakthroughs in technology, by 'locking in' large portions of the budget based on decisions made in previous years by previous Congresses and administrations. Stated differently, there is an underlying concern that with relaxation of the full-funding policy, MYP would develop a momentum of its own, because the financial and political pressures to continue the programs would be so high as to inhibit any significant numbers of cancellations even when such actions would be in the national interest. A service proposing a cancellation would first have to go through a rigorous justification showing that the requirement no longer exists, and it would then have to identify the resources for implementing the cancellation. No matter how justified such a decision might be, it is likely to evoke in the news media unpleasant allegations of waste and abuse. The threat of such allegations, coupled with a strong lobbying effort to be expected from the contractor, is likely to act as a strong inhibitor to any cancellation.<sup>59</sup>

Present DOD policy, as stated in the September, 1983, version of DOD Directive 7200.4, on the funding of multiyear contract's cancellation liability distinguishes between recurring and nonrecurring costs. It is now the general

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policy of the Department of Defense not to create unfunded liabilities for EOQ procurements associated with multiyear contracts, but rather to include funding for EOQ advance procurement budget requests, unless an exception is granted by the Assistant Secretary of Defense (Comptroller). EOQ procurements will normally be funded to the "termination liability" level, unless they are fully funded or an exception has been granted to include EOQ costs in an unfunded cancellation clause. Formerly only unamortized nonrecurring initial costs were included in cancellation liabilities, subject to the statutory cancellation ceiling, of course, but the cancellation liability was not required to be funded. Now, recurring costs also may be included in cancellation liabilities. The greatest cost savings associated with multiyear contracts lie in this newly-authorized ability to make economic order quantity purchases of parts, materials, components and associated labor. When unamortized recurring costs are included in the cancellation liability, DOD Directive 7200.4 requires them to be funded to the level of "termination liability" -- despite the FAR's provision in 17.103-1 (f) that "[c]ancellation charges need not be funded before cancellation. Unamortized nonrecurring costs continue to be treated as unfunded contingent liabilities.

"Termination liability funding" means, in this multiyear context, an amount of funds which would be required

to pay the cost of ending future requirements, on the last day of a fiscal year: "the maximum value of outlays that could be incurred for work accomplished by the end of the budget year plus the maximum cost to the government associated with termination of the contract at the end of the budget year." If a multiyear contract is ended in this way, the "termination liability" will include the cancellation charge comprising unamortized nonrecurring costs, and any unamortized, recurring, economic order quantity costs. This recurring costs liability will have been funded, but the nonrecurring costs liability will not have been.

This policy has greatly reduced the utility of multiyear contracting, because the greatest potential savings are found in economic order quantity (EOQ) purchases. To the extent EOQ's are made, their associated termination liability currently must be funded, which increases the TOA required for those multiyear contracts. This increased TOA is commonly perceived as diminishing that available for other programs.

This is a fundamental change from the former treatment of cancellation liability -- in what is often called "classical multiyear contracting" -- as a contingent liability that need not be recorded as an obligation until realized. In fact, it seems that few major weapon systems, if any, have been cancelled in the past. To insist that contingent

recurring cost cancellation liability be fully funded seems an expensive way to retain managerial flexibility that virtually eviscerates the enlarged multiyear procurement authority the Congress granted.

The DOD acquisition community regards the full-funding policy as presenting an unnecessary front-end budgeting bow wave that needlessly ties up TOA, in view of the fact that, historically, the probability of implementing cancellations is extremely small. Specifically, they consider the additional TOA provided by OSD for multiyear procurement in the FY 83 budget submission as being at the expense of their other valid requirements. They argue that continued attempts by Congress, OMB, and the DOD financial communities to force-fit full-funding policies on multiyear procurement will result in a nullification of the opportunities provided in this area by the 1982 DOD Authorization Act, and that MYP of major weapons systems will then revert back to the dormant state in which it existed for almost a decade until the passage of that Act.<sup>60</sup>

Alternatives to initially fully funding the recurring cost portion of the whole cancellation liability might include incremental funding (with perhaps no provision for any cancellation liability, beyond funds provided each year available to the contract), "expenditure" funding of only advance buys (to a level covering only the contractor's estimated invoiced expenditures to the end of each fiscal year, funding only the potential termination liability (as in the past, with the cancellation liability unfunded as a contingent liability), or only partially funding the cancellation liability with a pool of funds the size of which would reflect the likelihood of cancellation of covered

programs.<sup>61</sup>

A compromise between full funding and incremental funding advocates which apparently was debated would have required funding each year to purchase that year's scheduled requirements and actual contractor billings for advance material and components, but the cancellation liability (which would then include both nonrecurring costs and unbilled recurring costs) would be unfunded. This compromise would have likely resulted in a much lower first-year TOA requirement.<sup>62</sup>

A recently-proposed compromise between DOD's financial community which generally favors full funding, and the acquisition community which generally favors unfunded cancellation ceilings, is "phased" funding:

The phased funding approach differs from the other approaches since it employs two steps to establish fiscal-year funding levels. In step one, funding is applied each fiscal year to fund the full value of the production aircraft, as well as the termination liability of long lead time items. The resulting profile applies no funding to cover EOQ cancellation liability . . . . At this point [in step two], funding levels for each fiscal year are examined to verify full coverage of contract termination liability in any given year.

. . . .

This alternative is a potential candidate for compromise. The acquisition community can support the approach because it is consistent with the multiyear law and the realities of the contract



cancellation process. In its view, the limitation of the unfunded liability to the additional investment unique to the multiyear contract makes it consistent with the intent of the expanded multiyear law. This focus on EOQ items is also consistent with the cancellation process because the funding is deferred pending a decision to cancel and subsequent determination of the final claim value. On the other hand, members of the financial community view it as the best of the unfunded alternatives, but closer examination is necessary to determine whether it can overcome the lack of discipline [in multiyear candidate proposal] and [funds] control which they perceive in all unfunded approaches.<sup>62a</sup>

It appears that DOD favors leaving at least some cancellation liabilities unfunded by exception, at least in smaller multiyear procurements:

DOD, however, has decided to maintain its current funding policy for major multiyear procurement programs while retaining the flexibility to allow for other funding methods when justified on a case-by-case basis. However, for smaller programs -- those not identified by a separate budget line item -- DOD has indicated the military services should be permitted to include recurring cost in an unfunded cancellation ceiling when justified in each instance. The decision was based on the findings of a working group of the DOD Council on Integrity and Management Improvement which was investigating alternative methods of funding multiyear procurements.

The group concluded that an overall change in funding policy to enable total obligation authority deferral would only result in a one time, short term benefit that could adversely affect program stability in the years to come. Nor would additional programs become candidates for multiyear contracting if the funding method were changed. There appears to be a tradeoff, according to the group, between budget flexibility and program stability.<sup>63</sup>

The inherent conflict between program stability and budget flexibility is at the base of the controversy. More program stability is argued to produce more cost effectiveness and more efficiency, while more flexibility preserves managerial prerogatives to change priorities in response to various pressures. One suggested approach is to seek agreement first within the agencies, and then with the Congress, on a list of programs of such high priority that they will be stabilized by inter-Branch agreement. This approach, if possible at all, would concededly create even greater program turbulence among those programs not on the stabilized list "because they will have to absorb the changes previously spread over all programs" as total obligational authority will always fluctuate as will, to some degree, internal agency program prioritization.<sup>64</sup> An intra-agency approach is to eliminate enough lower priority programs to supply the obligational authority necessary to stabilize the remaining programs.<sup>65</sup>

#### 4. Comments

Multiyear contracts could produce some program stability, due to the high cost of cancellation, but the present requirement to obligate funds to cover contingent, unamortized recurring costs to retain the flexibility to cancel greatly diminishes the availability and utility of

multiyear contracts. Still, to the extent multiyear contracts are undertaken, they contribute to program stability by requiring a large front-end financial commitment.

Multiyear appropriations -- providing all funds needed for program requirements in their initial year -- might multiply the problem posed by funding cancellation liabilities manyfold, requiring enormous budgets and great unexpended year-end obligation authority balances to be carried forward. Another approach would be multiyear authorizations:

The only practical approach mentioned to date to obtain a multiyear commitment would a multiyear authorization for a stabilized program, and supporting language in the annual appropriations act. The authorization would serve as standing statutory approval for the program at its stabilized level. The appropriation act would establish, by statute, a congressional requirement to maintain production at the stabilized rate and for supporting budgeting and appropriation actions by the Department of Defense and Congress respectively. Though this approach would not remove all flexibility (prior laws can be repealed), it makes instability difficult and provides a positive show of congressional support. Only the factors of inflation or other necessary changes would result in variation in the funding established by the initial (and subsequent) appropriation statutes.<sup>66</sup>

Program stability cannot be created within the agencies alone, since they are only creatures of national policy established by the Congress. Program stability can only be created by a conscious surrender of some degree of budgetary and programmatic flexibility, an assumption of

greater willingness to form long-term commitments reflecting a degree of consensus that is inherently difficult to achieve in our system:

A great problem with the way we do business is the turnover of decisionmakers. Even if present top defense managers and congressional leaders make appropriate decisions to require only selected systems, their successors have no restraints forcing them to live with the prior choices. The temptation is too great to initiate something else and, rather than cancel the prior effort, to reduce it and stretch it out. The only tactic that appears feasible to control this instability is a multiyear commitment that is both difficult and instantly costly to undo.<sup>67</sup>

Once major procurements are underway, there appears to be a "prevalent belief in Washington . . . that cancellation or early termination carries formidably high political cost."<sup>68</sup>

### **C. Potential Liability for Proposal/Bid Preparation Expenses**

Another aspect of funding instability arises when, in seeking to preserve mission continuity or an early contract start when funds are expected to become available, agencies might issue IFB's or RFP's for projects which never are funded in fact or, although initially funded, become unfunded through withdrawal of funds as a consequence of a reprogramming action. Bidders or offerors may have expended considerable

time and resources in competing for a contract never let. They might reasonably ask whether the government should be liable for bid or proposal preparation costs.

The Comptroller refused relief in a case in which a reprogramming action resulted in an RFP's cancellation because funds became unavailable after the RFP's issuance due to withdrawal as part of a reprogramming action, even though the Navy violated DOD reprogramming directives by failing to complete a form which would have recorded its rationale for the reprogramming. The protester had undergone two preaward surveys, the first of which resulted in a nonresponsibility determination that was later changed to a favorable determination shortly before the Small Business Administration (SBA) issued a Certificate of Competency (COC). The protester asserted that the reprogramming was intended by the Navy to preclude award to it by assuring unavailability of funds, despite its apparent responsibility and its lowest cost proposal.<sup>69</sup>

The Comptroller agreed the government could be liable for bid or proposal preparation expenses in some circumstances, but maintained that the protester must affirmatively prove the government's liability:

We think it is clear that the Government may breach its implied contract to fairly and honestly consider proposals at any stage of the procurement process short of award. The question is whether ARF's proposal received a fair consideration, or whether action of the Government arbitrarily deprived ARF of a fair opportunity for award. It must be emphasized, at this point, that unfair or prejudicial motives will not be attributed to individuals on the basis of inference or supposition. Datawest Corporation, B-180919, January 13, 1975, 75-1 CPD § 14.<sup>70</sup>

The Comptroller applied the Court of Claims standards for liability:

The standards applicable to claims for proposal preparation costs have evolved from the courts in response to claims that the Government did not fairly and honestly consider the proposals submitted to satisfy the Government's requests for proposals. The ultimate standard to be applied is whether the Government's conduct was arbitrary and capricious toward the offeror. Keco Industries, Inc. v. United States, 492 F.2d 1200, 203 Ct. Cl. 566 (1974). Keco indicates four ways by which the ultimate standard may be satisfied: (1) subjective bad faith on the part of procuring officials which deprives the offeror of a fair and honest consideration of its proposal; (2) no reasonable basis for the administrative action; (3) a sliding degree of proof commensurate with the amount of discretion afforded the procuring officials; and (4) proven violation of pertinent statutes or regulations which may suffice for recovery. Proof establishing any one of the above connotes a breach of the implied contract that goes with each Government solicitation that if the offeror expends the effort and expense to prepare a response to the Government's solicitation, the Government will fairly and honestly consider that proposal.<sup>71</sup>

However, the Comptroller reaffirmed the propriety of cancelling a solicitation "where there are not sufficient funds to cover the contract," if there is no evidence that the

offer was solicited in bad faith or was not fairly and honestly considered for award.<sup>72</sup>

The last Keco test for liability seems to equate violation of regulations or statutes with arbitrary agency action sufficient for recovery, and

[i]n fact, it is upon this basis that the only two suits for bid preparation cost have been successful: Armstrong & Armstrong, Inc. v. United States, 356 F. Supp. 514 (E.D. Wash. 1973); and The McCarty Corporation v. United States, 499 F.2d 633, 204 Ct. Cl. 768 (1974).<sup>73</sup>

But the Comptroller refused to regard the Navy's violation of regulation as sufficiently serious to equate with arbitrariness, apparently because the reprogramming regulations allow for wide agency discretion which, under the third Keco test, would require a very high degree of proof of agency failure to fairly and honestly consider the protester's proposal. In effect, a protester would be required to demonstrate that the agency action had no reasonable basis whatsoever.

Accordingly, for a losing contractor to recover his bid or proposal costs in the face of asserted funding unavailability, he must show that rejection of his proposal was motivated by the bad faith of some agency official.<sup>74</sup> Further, he must also be able to show he had a substantial

chance of receiving the award were it not for the agency's arbitrary, bad faith act.<sup>75</sup> Such a showing would be well-nigh impossible where the disabling funds unavailability was not first shown to be the result of active bad faith, not just inefficiency or negligence.<sup>76</sup>

In the FPR, there was no requirement that contracting officers check into funding availability before issuing solicitations,<sup>77</sup> although DAR 2-201 (b)(xli) required contracting officers to determine and record the amount of funds available for a procurement involving base bids and alternates.<sup>78</sup> The FAR, in 32.702, requires obtaining written assurance of funds availability before the execution of contracts. The Comptroller distinguished between the Availability of Funds for Next Fiscal Year clause condition which establishes a limit on the government's liability under the contract, and the evaluation and award contingency making award "subject to availability of funds for the proposed [method of acquisition]" when proposals were solicited on four methods and the contracting officer had not checked into availability for each method. In fact, funds were not available and were not expected to be made available by reprogramming procurement funds (for purchase), while operation and maintenance funds actually were available (for rental). "[T]he evaluation and award contingency establishes that award is to be based on funds presently budgeted or



reprogrammable or, with respect to future fiscal years only, reasonably expected to become available."<sup>79</sup> The Comptroller reasonably concluded that the two contingencies must be different, or contracts conditional on future appropriations availability could never be awarded. He also took notice that funds in different appropriations are not generally interchangeable through reprogramming.<sup>80</sup>

Further, even the use of an incremental funding (Limitation of Funds) clause in a solicitation stating that funds are available for the first year of performance creates no "implied promise" that funds will not later be withdrawn nor any obligation of the agency to fund the contract at all: "Indeed, the clause merely informed the offeror that if a contract were awarded funds would only be obligated for the first year of the program."<sup>81</sup>

Bid or proposal costs, which may sometimes later be partly absorbed into overhead expenses under Bid and Proposal (B&P) allowances negotiated for larger contractors,<sup>82</sup> otherwise will simply be lost to contractors who do not receive awards. The Comptroller's view is that

These are risks which are inherent in Government contracting and their occurrence does not entitle an offeror to proposal preparation costs unless there has been arbitrary or bad faith action on the part of the agency.<sup>83</sup>

#### Chapter IV: Footnotes

1. See generally, R. Nash and J. Cibinic, I Federal Procurement Law, Chapter 10, Section 3, "Contracting Without Appropriations" (1977).

2. Id. at 677.

3. DOD policy, as expressed in DAR 1-315, was to encourage contractor capital investment. Various techniques available in the DAR were designed to effectuate this policy: The DOD profit policy, DAR 3-808.2; multiyear procurement, DAR 1-322; award fee contracts, DAR 3-405.5; and the special capital investment incentive provisions, DAR 3-815. Capital investment incentive provisions are designed to overcome contractor reluctance to invest in long-lived capital assets despite the short duration of defense development and production contracts and the uncertainty of follow-on contracts which might permit some further productive use of special equipment. The capital investment incentive provisions call for government buy-back of qualified, unamortized plant items that the contractor does not wish to retain upon premature termination of a contract. "The government indemnifies this [capital] investment against program termination. The dollar amount is specified in the

contract and as a footnote in the congressionally approved budget for the program. The amount is not funded unless termination takes place." Polesky, Multiyear Contract Cancellation Ceiling -- An Alternative to Full Funding, 18 Nat. Cont. Management J. 15, 21 n.10 (1984). FAR policies do not reflect this emphasis, precisely because civilian agencies generally do not share DOD's need for unique defense-related items. The military services must often develop the products needed, create their own market, and then, of course, ensure that all prospective contractors who risk venturing into that market are governed by similar rules. The FAR, in Subpart 17.1, does permit multiyear contracting, and in Subpart 16.4, does provide for cost-reimbursement incentive contracts, including technical performance incentive (award fee) contracts. DOD has continued its investment incentive policies in DOD FAR Sup. 15.872, "Capital investment incentives," and in 15.902, its profit policy provision.

4. See H. R. Rep. No. 91-1570, 91st Cong., 2d Sess. 8 (1970); DOD Appropriations Act, 1971, Pub. L. No. 91-668, § 842, 84 Stat. 2020. Among other significant effects, this change caused program managers to shift their attention within the funds management phases -- initiation, commitment, obligation, and expenditure -- from commitment to actual obligation.

5. 56 Comp. Gen. 142, 153 (1976), overruling B-164908, July, 1972, unpub. When annual funds are used -- and, perhaps, when multiple-year funds are used after the codification language change in 31 U.S.C. § 1502 -- the government may not agree to cancellation penalties intended to recapitalize the contractor for future years' unrecovered costs, but a higher base rate in the first year than for subsequent years may be agreed, with award going to the offeror proposing the lowest contract price considering all options expected to be exercised, rather than to the offeror that proposes the lowest initial period base contract price. 56 Comp. Gen. at 156. See also 56 Comp. Gen. 167 (1976)(companion case); 37 Comp. Gen. 155 (1957); 36 Comp. Gen. 683 (1957).

6. Singer & Brabson, Enhanced Multiyear Procurement for Improving Weapon Systems Acquisition, 5 Concepts 112, 117, 122 (1982).

7. Id. at 122, citing the Report of the Defense Preparedness Association (ADPA) Seminar, "Use of Multiyear Concepts in Defense Acquisition," May 29, 1981.

8. Implemented in DOD by DOD Directive 7200.4, "Full Funding of DOD Procurement Programs," September 6, 1983.

9. DOD Directive 7200.4, October 30, 1969 at paragraph III.A (emphasis added). This directive has been superseded by the September, 1983, version but the sense of the full funding policy has not been changed.

10. Comp. Gen. Dec. B-162389, December 19, 1967, unpub.; cf. Radionics, Inc., ASBCA 20796, 77-1 BCA ¶ 12,448 (1977).

11. DOD Directive 7200.4, "Full Funding of DoD Procurement Programs," October 30, 1969 at paragraph III.E. See also the present DOD Directive 7200.4, September 6, 1983 at paragraph E.1.

12. AFR 172-14, "Full Funding of Air Force Procurement Programs," October 1, 1981, at paragraph 1.b.

13. GAO Report No. PAD-78-80, "Further Implementation of Full Funding in the Federal Government," September, 1978.

14. Budget Terms at 60, 63.

15. Dews & Rich, "Multiyear Contracting for the Production of Defense Systems: A Primer," RAND Note No. N-1804-AF at 25-26 (1982).

16. Id. at 2.

17. Id at 15-16 & note thereon (emphasis added).

18. Budget Terms at 60, 63.

19. Fedak, Government Procurement LL.M. thesis found at The National Law Center, The George Washington University, Washington, D.C., "Acquisition of a Foreign Weapon System Through the Use of an Executive Agreement," September, 1981 at 72.

20. See AFR 172-14, note 12 supra.

21. GAO Report No. CED-80-53 (B-197149), "An Analysis of DOD's Family Housing Management Account and Lease Construction Agreements," February 2, 1980 at 14-15.

22. 55 Comp. Gen. 812, 822-826 (1976).

23. Id. at 822; see DOD Directive 7200.4, note 8 supra.

24. 55 Comp. Gen. at 822.

25. Id. at 823.

26. Id. at 826.

27. See, e.g., Gordon, Pentagon Costs Overruns, a Venerable Tradition, Survive Reagan's "Reforms", National Journal 56 (January 8, 1983).

28. 10 U.S.C. § 139c.

29. Large, "Bias in Initial Cost Estimates: How Low Estimates Can Increase the Cost of Acquiring Weapons Systems," RAND Report No. R-1467-PA&E, July, 1974.

30. Id.

31. See 42 Comp. Gen. 640 (1962).

32. FAR 17.102-3 (d)(4).

33. Sen. Rep. No. 92-359, 92d Cong., 2d Sess., 98 (1971); see generally Gallimore, Legal Aspects of Funding Department of the Army Procurements, 67 Mil. L. Rev. 142-147 (1975).

34. The Air Force follows a fiscal year integrity policy with all time-limited appropriations. See AFR 170-8, "Accounting for Obligations," November 1, 1981, paragraph 8.b.; AFR 177-120, "Central Procurement Transactions," Chapter 2,

November 16, 1978; AFM 172-1, "USAF Budget Manual," Volume 1, Chapter 14, May 15, 1982.

35. See AFM 172-1, "USAF Budget Manual," Volume 1, Chapter 13, April 30, 1984.

36. See AFM 172-1, "USAF Budget Manual," Volume 1, paragraph 14-3 and figure 14-1.

37. Rich, "Congress and Competition," RAND Paper No. P-5850, April, 1977 at 8.

38. *Id.* at 5.

39. Dews & Rich, note 15 *supra* at 6-7, citing Department of Defense Authorization Act, 1982, Pub. L. No. 97-86, 95 Stat. 1118-1120; House Rep. 97-311, 1981; S. 815, Department of Defense Authorization Act of 1982; H.R. 3519, Department of Defense Authorization Act of 1982; House Committee on Appropriations Subcommittee on the Department of Defense Hearings, "Department of Defense Appropriations for 1982," Part 3 at 721-835 (1981); House Armed Services Committee Panel on Defense Industrial Base, H.A.S.C. Doc. No. 96-69, 1980, and Committee Print No. 29, 1980; House Armed Services Committee Hearing, "Multiyear Procurement," H.A.S.C. Doc. No. 97-11, 1981; Memoranda, "Improving the Acquisition Process" and



"Policy Memorandum on Multiyear Procurement," from Deputy Secretary of Defense Carlucci to Secretaries of the Military Departments and Others, April 30, 1981 and May 1, 1981; Memorandum, "Funding of Multiyear Procurements," from Under Secretary of Defense DeLauer for Secretaries of the Military Departments, October 5, 1981; Defense Science Board, "Summer Study on Industrial Responsiveness," 1980; GAO Rep. No. PSAD-78-54, "Federal Agencies Should Be Given General Multiyear Contracting Authority for Supplies and Services, 1978. See also Brearey, "An Analysis of the Impact of Multiyear Procurement on Weapon System Acquisition," thesis submitted to Air Force Institute of Technology, Air University (ATC) at 41-57 (1981).

40c. See generally, Cox, "More-Than-One-Year Production Contracts: A Guide To Contracting Concepts," March, 1981, found at Headquarters, United States Air Force, DCS/Research, Development and Acquisition, Directorate of Contracting and Manufacturing Policy, Washington, D.C.

41. See FAR 32.704-1; DAR 7.203.3 (b), 7-402.2 (c), 7-402.2(d); and FPR 1-7.202-3(b), 1-7.402-2 (c), 1-7.402-2 (d).

42. Memorandum from J. H. Summers, FAR Project Manager, to Mr. William J. Maraist, Assistant Administrator for

Regulations, OFPP, August 30, 1982 at 6. Attached to this memorandum, the spreadsheets recording the comments of interested parties on the Phase I FAR Part 32, Subpart 32.7, and the reactions of the FAR Project Office.

43. Cox, note 40 supra.

44. Id. at 11-13.

45. Id. at 12.

46. Analysis, Multiyear Contracts -- Now You See It, Now You Don't, 39 Fed. Contr. Rep. 972, 973, quoting Slay, A New Look at an Old Remedy: Multiyear Contracts and Defense Management, 1982 Defense Management J. 20, 22.

47. Singer & Brabson, note 6 supra at 117.

48. Pub. L. No. 97-86, § 909, 95 Stat. 1099, 1118-1120, December 1, 1981, codified in relevant part at 10 U.S.C. §§ 2301, 2306 (g) & (h). Legislative history may be found at 1981 U.S. Code, Cong. & Admin. News 1781. See Singer & Brabson, note 6 supra at 118.

49. 10 U.S.C. § 2306 (h)(1).

50. See GAO Rep. No. NSIAD-85-9, "Analysis of DOD's Fiscal Year 1985 Multiyear Procurement Candidates," October 25, 1984.

51. Singer & Brabson, note 6 supra at 119. Determination of suitability for multiyear contracting has been delegated in the Air Force to the Head of the Contracting Authority (HCA) level, but such determinations for multiyear contracts for property must be made by the Assistant Secretary of the Air Force for Research, Development and Logistics when the cancellation ceiling is over \$100 million. AF FAR Sup. 17.103-1. In no event may solicitations be issued until this determination has been made.

52. Pub. L. No. 98-212, § 760, 97 Stat. 1449, December 8, 1983. The required notice could be accomplished by inclusion in the annual budget estimate submission, a reprogramming action or a letter.

53. See, e.g., DOD Authorization Act, 1983, Pub. L. No. 97-252, § 107, 96 Stat. 721, September 8, 1982.

54. Puritano, Resource Allocation in the Department of Defense, 29 Armed Forces Comptroller 10 (1984).

55. Dews & Rich, note 15 supra at 31.

56. Singer & Brabson, note 6 supra at 119, 121-122.

57. Dews & Rich, note 15 supra at 33-34.

58. See Analysis, note 46 supra at 974; Utgoff & Thaler, "The Economics of Multiyear Contracting," Center for Naval Analysis Professional Paper No. 345, March, 1982; Comp. Gen. Dec. B-206570, February 1, 1984, unpub. (analysis of Air Force's claimed savings on DSCS III proposed multiyear procurement).

59. Singer & Brabson, note 6 supra at 119-120.

60. Id. at 120-121.

61. Id. 121.

62. Bergjans & Elbroch, "An Analysis of the Predicted Benefits of Multiyear Procurement," thesis presented to the School of Systems and Logistics of the Air Force Institute of Technology, Air University (ATC) at 7-9 (1982).

62a. Polesky, Multiyear Contract Cancellation Ceiling -- An Alternative to Full Funding, 18 Nat. Cont. Management J. 15, 18-19 (1984).

63. Analysis, note 46 supra at 975.

64. Schutt & Acker, Program Stability: An Essential Element in Improved Acquisitions, 5 Concepts 148, 149 (1982).

65. Id. at 153.

66. Goldstein, Reducing the Bow Wave in Defense Budgeting, 4 Concepts 75, 78 (1981).

67. Id. at 77.

68. C. Liske & B. Rundquist, The Politics of Weapons Procurement: The Role of Congress 87 (1974).

69. 56 Comp. Gen. 201 (1976).

70. Id. at 208.

71. 56 Comp. Gen. at 205.

72. Id., citing Ocean Data Systems, Inc., Comp. Gen. Dec. B-180248, 74-2 CPD ¶ 103 (1974); TIMCO, B-186177, 76-2 CPD ¶ 242 (1976).

73. Id. at 207.

74. Computer Engineering Assoc., Inc., Comp. Gen. Dec. B-198019, 81-2 CPD ¶ 105 (1981).

75. 60 Comp. Gen. 36 (1980).

76. Robert F. Simmons & Assoc. v. United States, 360 F.2d 962 (Ct. Cl. 1966); Bradford National Corp., B-194789, 80-1 CPD ¶ 183 (1980); Arlandria Const. Co. -- Reconsideration, B-195044, 80-2 CPD ¶ 21 (1980).

77. 60 Comp. Gen. 331, 336 (1981).

78. 55 Comp. Gen. 443 (1975).

79. 60 Comp. Gen. at 333.

80. Id. at 334.

81. Comp. Gen. Dec. B-199540.3, November 16, 1982, unpub., at 8.

82. See, e.g., DAR 31.205-18; FAR Subpart 42.10.

83. Comp. Gen. Dec. B-199540.3, November 16, 1982 at 9. But cf. General Dynamics Corp., Convair Div., ASBCA 15394, 15858, 72-2 BCA ¶ 9533 (1972), where the board stated:

To the extent that the Government argues that if the costs in question are allowable they must be considered development costs, we note that if bidding and proposal costs are chargeable only to the contract toward which they are directed, reimbursement for unsuccessful bids and proposals would always be denied.

Id. at 44,403.

## **Chapter V. Contracting Techniques**

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## **Chapter V. Contracting Techniques**

Various contracting techniques have been evolved by the agencies to lessen the impact on the formation and administration of contracts that implement their approved programs of statutory and regulatory fiscal control restraints. These include contracts awarded before appropriations conditional on funds availability, indefinite delivery contracts, letter contracts, pre-contractual Basic Agreements and Basic Ordering Agreements, multiyear procurement, and advance procurement of parts, materials and components. These techniques are discussed in this Chapter. In each case, the FAR clauses prescribed are included to permit the reader to examine their provisions.

### **A. Conditional Contracts -- Beginning Procurement Before Funds Become Available**

Making a contract expressly conditional on availability of a later appropriation is the main technique used to contract before appropriations. This technique is used to avoid the delay of waiting for appropriations before contracting -- this is particularly important in view of Congress' lateness in appropriating funds and the

administrative delays in apportioning and allocating funds. Accordingly, this technique is used near the end of a fiscal year so that a contractor can begin work as quickly as he receives notice from the contracting officer that funds have been appropriated. The Comptroller approved this practice, if the awards were specifically subject to funds availability and specified that the government would not be obligated until the expected appropriation had passed.<sup>1</sup> The FAR meets these requirements and also requires that the government may not become liable until written notice of funds availability is given by the contracting officer. The Antideficiency Act is not violated because no government obligation -- either fiscal or promissory -- arises under the contract until these events occur.

However, if there is any possibility that the government might somehow become obligated to make payments before appropriations become available, the agencies may not give notice of award.<sup>2</sup>

### **1. Generally**

As a general matter of law, a conditional promise will be consideration sufficient to render binding and enforceable at law -- to be "supporting" consideration for -- a return promise. It will not be an illusory promise if the promisor

honestly believes the event constituting the condition is possible and the event is not under the control of the promisor. Further, a duty subject to a condition does not become due until the event occurs, and nonoccurrence of the condition is not a breach unless he has assumed a duty that the condition occur.<sup>3</sup> Conditions may be express or implied, and precedent, concurrent or subsequent. For example, contracts conditional on the availability of funds may expressly relieve the government of its duties under the contract if the precedent event of availability of adequate appropriations does not occur, and the contractor's duties would be subject to implied concurrent conditions relieving the contractor of its duty to perform when the government failed to perform. These conditions are not of the sort that render contracts invalid for lack of an "unequivocal" or definite acceptance, because both parties expressly accept the condition: the offeror/bidder's offer incorporates the condition precedent, as does the government's acceptance.<sup>4</sup>

The Comptroller has approved conditional contracts awarded prior to the enactment of the relevant appropriation act. Conditional contracts must expressly provide that the government's liability is contingent on the future availability of appropriations to support it. To avoid antideficiency violations, or any moral or government quantum meruit or quantum valebant liability for goods or services

accepted by the government, performance may not begin prior to the date of enactment of the appropriations. Performance may begin after the enactment of the appropriation and before the start of the fiscal year, although no payment may be made under the contract until the fiscal year begins and the contract may not be drafted to impose a payment obligation on the government prior to the beginning of the fiscal year.<sup>5</sup>

As developed in Chapter III, conditional contracts funded with annual funds -- such as automatic renewal clauses conditional on availability of new appropriations -- have been held by the Supreme Court in Leiter v. United States<sup>6</sup> to not bind the United States beyond the first fiscal year, unless the government reaffirms the original contract by a "Leiter affirmative act" under the authority of an appropriation for each subsequent year. Only after the affirmative act has occurred would a binding obligation of the new fiscal year's funds arise.<sup>7</sup>

The DAR, in DAR 1-318(a), limited use of conditional contracts to operation and maintenance and continuing services which must be funded with annual operations and maintenance funds, for which Congress generally appropriates funds because these expenses are required to maintain normal operations levels. Further, DAR 1-318(c) forbade acceptance of supplies or services by the government under conditional contracts --

to prevent any government obligation for payment -- until two events have occurred: 1) funds actually become available to the contracting officer, and 2) written notice of availability has been sent to the contractor.<sup>8</sup> As noted above, these restrictions have been continued in the FAR without change.

Awards made subject to availability of funds or approval of higher authority are recognized as obligations of the government without any later action of the contracting officer if approval is obtained or funds become available.<sup>9</sup> But if funds are not obtained or the awards not approved, no obligation has been incurred under the contract.<sup>10</sup>

Professors Nash and Cibinic question whether such conditional contracts should be thought to prevent the formation of a contract until the specified condition occurs, or merely to not obligate the government until the condition occurs.<sup>11</sup> As an example of such a questionable decision, they cite a Comptroller's decision in which it was held that no contract was formed because of lack of mutuality of obligation.<sup>12</sup> This seems clearly wrong. A contract was formed, as the government promised unequivocally to be bound if some possible, uncontrolled event occurred, but the stated condition relieving the government of its obligation to perform occurred and thus -- as an implied concurrent condition -- relieving the contractor of its reciprocal

obligation to perform.

## 2. Funds Available Clauses

Professors Nash and Cibinic write that federal agencies have been reluctant "to take full advantage of their authority" in the area of use of express statutory contract authority to procure goods and services for more than one year.<sup>13</sup> In C. H. Leavell and Co. v. United States,<sup>14</sup> it is noted that the Corps of Engineers sought congressional approval of its "continuing contracts," even though they were founded on express statutory contract authority. After Leavell, the Comptroller overruled his prior holding that the Corps must include in its "funds available" clauses a limitation of the government's obligation to the amount actually appropriated for contract payments,<sup>15</sup> because the Corps' "continuing contracts" were entered into pursuant to express contract authority and not under the implied contract authority of an appropriation.

When agencies operate under budget authority in the form of contract authority -- which gives agencies power to enter into contracts both without appropriations and without conditioning them on funds availability -- rather than in the form of appropriations, the Antideficiency Act does not prevent government liability for the full extent of the

contract obligation.<sup>16</sup> It is true that accounting officers may not disburse funds to satisfy the unappropriated portion of the obligation, but claims for such amounts may still be enforced in the Claims Court. In New York Airways, Inc. v. United States,<sup>17</sup> the court found an implied in fact unilateral contract formed when carriers actually transported mail under a Civil Aeronautics Board rate order, which the court construed as an offer to pay a set rate for the transportation of mail. It was in Shipman v. United States,<sup>18</sup> that the Court of Claims first recognized this principle in construction contracts.

In Leavell, the Army Corps of Engineers had sought explicit statutory authority to award long-term construction contracts without having appropriated funds available in the full contract amount at the time of award. This authority is codified at 33 U.S.C. § 621:<sup>19</sup>

Any public work of canals, rivers, and harbors adopted by Congress may be prosecuted by direct appropriations by continuing contracts, or by both direct appropriations and continuing contracts.

However, in Leavell, the question arose of the efficacy of the "funds available" clause as an express contractual limitation of government liability for contractor costs resulting from a suspension of work on one of its continuing contracts when funds allotted to the contract were



curtailed. The plaintiff sought an equitable adjustment under the Suspension of Work clause for its added costs incurred when work was suspended for six months after an appropriation curtailment.

The court held an equitable adjustment under the Suspension of Work clause should be available for this "unreasonable" suspension, even though the cause was appropriation curtailment the occurrence of which the parties had foreseen and the consequences of which they had attempted to deal with under the standard "Funds Available" clause, SP-19. This clause provided that the contractor could elect either to suspend operations, consider the contract terminated, or continue work without payment:

If the contractor so elects, . . . he may continue work . . . under the specifications, so long as there are funds for inspection and superintendence, with the understanding, however, that no payment will be made for such work unless additional funds shall become available in sufficient amount.<sup>20</sup>

The Comptroller of the Treasury previously had decided the agencies would not violate the Antideficiency Act by entering into contracts for full completion of contracts without sufficient appropriations to pay for full performance, provided the government's obligation to pay was specifically limited to the appropriated amount and any payment above that was expressly conditional upon future appropriations.<sup>21</sup>

In Leavell, the court noted the operation and impact of the administrative allocation and allotment system. Congress appropriated funds by project, not by individual implementing contracts. The Office of Chief Engineer then allocated funds to the districts, and at the district level actual allotment to particular contracts occurred. The district engineer had authority to transfer funds between contracts implementing a project, and some authority to transfer funds between projects. The allotment need only be rational and nondiscriminatory to shield the government from liability for harm resulting from the shortage.<sup>22</sup> The court concluded that the available funds were allotted reasonably and nondiscriminatorily, even though the funds available for the contract in issue were rendered inadequate.<sup>23</sup>

Still, relief was allowed as a matter of contract interpretation under the Suspension of Work clause, despite the language in SP-19 reading

It is understood and agreed that the Government is in no case liable for damages in connection with this contract on account of delay in payments to the Contractor due to lack of available funds,

which the court found ambiguous, calling for application of the contra proferentem rule. The court concluded that the history of the "funds available" clause and the wording of the

particular clause in Leavell led plausibly to the conclusion that it was intended to shield the government only from breach damages and not from added costs attributable to a contractor's standby costs under a funds shortage suspension.<sup>24</sup>

Prior to the development of the "funds available" clauses, any failure on the part of Congress to fund an existing government contract was held to be a breach of contract,<sup>25</sup> for which the full breach measure of recovery was available as a remedy. The Interior board concluded that the "funds available" clauses were intended to prevent this result by putting a contractor on notice that exhaustion of funds would not be a breach and that he would bear all the risks and costs of suspensions due to funds unavailability no matter what the cause.<sup>26</sup>

The Corps' continuing contracts were intended to permit contracting for large civil works projects "in a comprehensive manner, rather than through a series of yearly work units."<sup>27</sup> Under its continuing contracts practice, a contract expected to stretch over several years was formed, but the contract was incrementally funded -- appropriations were sought each year to cover only payments required in each year. Formerly, the Corps had fully funded these projects, but this practice had resulted in large unexpended balances

remaining at the ends of fiscal years.<sup>28</sup> In 1892, Congress began to enact contract authority for certain specifically approved projects, and these were recognized as exceptions to the Antideficiency Act's proscription against contracting in advance of or beyond appropriations. Permanent contract authority for these continuing contracts was enacted in 1922. After the Leavell case, the Corps sought the Comptroller's approval to remove the limitation of government liability to amounts actually appropriated each year and to (1) pay interest on delayed payments, (2) allow contractors termination for convenience settlements if payments were inordinately delayed due to congressional failure to fund their contracts, (3) to assure contractors of eventual payment of earned amounts, and (4) to prevent successful suspension or delay of work claims for delayed payments. These changes were sought to ensure equitable treatment of contractors and to obtain lower bids and contract costs by reassuring them that the Corps would be bound to continue its practice of "ultimately" making all payments earned "nearly always . . . as soon as they were earned." <sup>29</sup>

The Comptroller approved these proposed changes in concept, although he noted that they would require change in the Corps' presentation to Congress of requests for budget authority for continuing contracts. The Comptroller clearly understood that this suggested practice would change these

contractual obligations from the status of being limited by appropriations to a status "based on the contract as written independent of the existence of liquidating appropriations."<sup>30</sup>

Obviously the Corps cannot 'assure' in an absolute sense any payments beyond the amount of appropriations available at the time the contract is made. Instead, it appears that the basic effect of this proposed change would be to treat the full contract price as a legal obligation, recordable under 31 U.S.C. § 200 (a)(1) (1970), even though appropriations sufficient to liquidate the full obligation are not available at that time. While it is conceivable in theory that Congress might still refuse to appropriate for the liquidation of such obligations, failure to appropriate would under the revised contract provisions leave the contractor with legal rights to recover for his contract earnings. See, e.g., New York Airways, Inc., v. United States, 369 F.2d 743 (Ct. Cl. 1966); Gibney v. United States, 114 Ct. Cl. 38, 50-52 (1949); Seatrail Lines, Inc. v. United States, 99 Ct. Cl. 272, 316 (1943).<sup>31</sup>

The Comptroller recognized that this practice would render the Corps' budget authority for these continuing contracts "complete as a matter of law" upon authorization, without regard to whether funds were later appropriated or not. This would stand in distinct contrast to the usual two-stage authorization-appropriation process and might produce long lags between initial authorization and ultimate provision of initial appropriations, and inevitably create uncertainty as to the government's obligation to ultimately provide appropriations at all.<sup>32</sup>

The Corps is also authorized to plan, design and construct some water resource improvements without specific preceding congressional authorization, although this authority is generally limited to specific ceiling amounts from funds "heretofore or hereafter" appropriated for the same general purposes. Further, these projects are required to be complete in themselves and may not commit the government to additional improvements. The Corps calls these its "continuing authorities" program.<sup>33</sup>

Sometimes, "funds available" limitations are specifically required by statute.<sup>34</sup> But the cases cast doubt on their efficacy as shields against government liability when the reason for funds insufficiency is a discretionary administrative reallocation, rather than congressional budget trimming.

Professors Nash and Cibinic cite two cases, both from the Bureau of Reclamation which involved clauses similar to that used by the Corps of Engineers in Leavell. In Granite Construction Co.,<sup>35</sup> the board refused to award relief under the Suspension of Work or the Changes clause because it found the President's impoundment of the allotted funds as part of an anti-inflationary policy not an act of the contracting officer and further because the contractor was put on notice that continuing to work at a rate exhausting available funds

would be "at his own risk," even though the contracting officer approved the accelerated work schedule.<sup>36</sup> In addition, since part of the delay was caused by a Presidential funds impoundment, this was a sovereign act for which Suspension of Work clause relief was unavailable. It is clear that an improper government failure to fund a contract is material breach that would justify a contractor's failure to perform.<sup>37</sup> The question remains when inadequacy of funds might render the government liable for delay or suspension costs, despite an availability of funds clause.

In S. A. Healy Co.,<sup>38</sup> the board held that relief under the constructive change doctrine might be available if the agency somehow was at fault in not requesting enough funds to cover the work schedule it had approved, and therefore the government's motion to dismiss should be denied. Later, the board concluded that no change had occurred because the government had in fact provided sufficient funds to cover the approved work schedule and the funds shortage would not have occurred if Healy had adhered to his approved work schedule, rather than accelerating to exhaust the apparently too-limited funds before the onset of winter.

But the Court of Claims reversed.<sup>39</sup> While the agencies involved in Leavell, Winston Brothers<sup>40</sup> and Granite Construction were not at fault in failing to provide funds

that were available, the court found that in Healy the agency had made a budget request that would be inadequate to fund the approved schedule. Also, while the agency made a supplemental budget request that actually was granted and would have sustained the approved schedule without interruption, the agency did not keep the contractor informed of its progress and left it to believe -- and act upon its belief -- that funds would certainly be exhausted. The court found first, that the apparently unambiguous language of the funds available clause, "the Government shall not be liable for damages under the contract on account of delays in payment due to lack of funds," could be interpreted reasonably as meaning that it allocated to contractors only the "risk of exhaustion of funds from action by Congress in cutting [budget] requests."<sup>41</sup>

Second, the court found part of the inherent, implied duty of cooperation and noninterference "either that the agency request the amounts it has approved for earnings, or, alternatively to disapprove the construction program [proposed] or otherwise promptly furnish such information about the flow of funds as the contractor will need to plan its own operations."<sup>42</sup> The court held that the "protective umbrella" of the funds available clause (as it was ambiguously worded in the contract) -- did not extend to funding inadequacies caused by the "agency's decision to request



funding grossly inadequate to support the level of earning approved by the agency for the fiscal year."<sup>43</sup>

We hold only that (a) a contract will not be construed to throw all the cost and loss necessarily incident to such a decision on the contract, and none of it on the party whose decision caused the loss, unless clauses of the contract require that result without ambiguity, and (b) that a government agency that claims a right to do this is under an implied obligation to assist its contractor, by timely and candid information to take the measures that the latter may deem best to diminish and mitigate its loss.<sup>44</sup>

The Court of Claims' reasoning in both Leavell and Healy has been criticized by the Engineering Board of Contract Appeals,<sup>45</sup> saying that the intent of the clause to impose the entire burden of risk of funds shortage on the contractor alone could hardly be made clearer, and

[t]o say that the disclaimer in the Funds Available for Payment clause bars breach of contract actions for delayed payments due to lack of funds, but not claims for equitable adjustments under the Suspension clause, when both clauses are present, means essentially that the disclaimer bars nothing.<sup>46</sup>

The board stated the decisions in Winston Brothers and in United States v. Blair,<sup>47</sup> were sounder. However, the board wrote it would adopt the Court of Claims statement in Leavell that agencies had ample authority to order a deceleration under either the Changes or Suspension of Work clauses, if they believe a deceleration would be more advantageous to the

government than a total work stoppage. These comments were gratuitous in the case the board was addressing, however, because the board held that the disclaimer in the Funds Available for Payment clause did not apply since there was neither a work stoppage nor any delay in payment. Therefore, the contractor was entitled to delay costs under either the Suspension of Work clause, for delay costs, or under the Changes clause, for extra or changed work.<sup>48</sup>

Despite such criticism, the Claims Court continues to apply principles derived from the Healy case. In Municipal Leasing Corp. v. United States,<sup>49</sup> the court cited Healy for the proposition that where an agency obligates itself contractually to use its "best efforts" to obtain funds (in that case to support exercise of a renewal option), failure to do so will constitute a breach of contractual duty. In Municipal Leasing, involving a computer lease to purchase contract which included a clause entitled Government's Intentions stating

It is the intent of the Air Force to exercise the options as specified . . . . The Air Force shall use its best efforts to obtain appropriations of the necessary funds to meet its obligations and to continue this contract in force. The Air Force shall not replace the leased equipment with functionally similar equipment during the term of this contract.<sup>50</sup>

The plaintiff successfully defended the government's motion for summary judgment, asserting that the government had improperly failed to renew the contract when "the only condition permitting non-renewal [assertedly unavailability of funds] did not exist."<sup>51</sup>

The government's motion had been predicated on the conditional contract's inclusion of both an Availability of Funds for Next Fiscal Year clause and a Termination for Convenience of the Government clause. The government argued in the alternative that it had the right to refuse to renew the contract either because funds were not made available administratively or because it might have terminated for convenience, in any event. The Claims Court rejected this defensive use of the Termination for Convenience clause, citing the principle of Torncello v. United States,<sup>52</sup> that Termination for Convenience clauses may only be "appropriately" invoked in the event of some change from the circumstances of the bargain or in the expectations of the parties and, in this case,

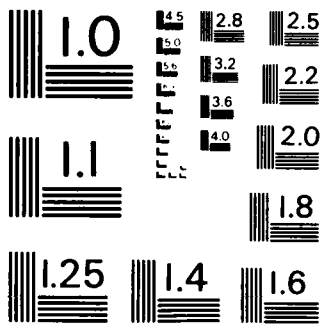
[a]ny lack of appropriated funds after the expenditure of the Air Force's 'best effort' to obtain such funds was part of the original circumstances of the bargain. Accordingly, having dealt with this event in [the Option, Availability of Funds, and Government Intention clauses] the agreements there reached may not be abrogated by the defensive and constructive use of convenience termination principles.<sup>53</sup>

It appears, therefore, that the Claims Court will not sanction the use of the constructive termination for convenience doctrine to save agencies from breach damages when conditional contracts are used if agencies have "improperly" failed to allocate funds to such contracts, absent some evidence of changed circumstances.<sup>54</sup>

It seems that the government also argued in Municipal Leasing that the Government Intention clause was invalid because it violated the fiscal control laws, but the court rejected this argument summarily, writing that "[a]ny judgment entered by this court for any breach of contractual duty would be paid from funds appropriated by Congress," citing then 31 U.S.C. § 724a, now section 1304, the permanent appropriation to pay final judgments, awards, compromise settlements, and interest and costs.

Thus, some government fault, perhaps unreasonable or discriminatory funds allotments, may leave the government liable for breach damages for suspending work due to funds shortages, despite the use of "funds available" clauses -- and further, that any ambiguity in risk allocation of costs attributable to such delays will be resolved in favor of contractor entitlement to reasonable delay costs.<sup>55</sup>





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Professors Nash and Cibinic conclude that "the funds available type clauses will be construed as covering a fairly narrow range of 'Congressional' action and that the clause will not preclude recovery if any type of agency fault can be found, and to the extent that such clauses remain ambiguous in defining the risk allocation intended by the Government in the event of delay due to exhaustion of available funds the favored construction will be that which affords the contractor a reasonable recovery for delay costs."<sup>56</sup>

## **B. FAR Contract Funding Provisions**

### **1. A Note on Terminology**

FAR policy on contract funding was intended to be produced without working any major policy changes from the DAR and FPR provisions used as models. Contract funding policy is set out in Part 32, Subpart 32.7. This guidance is not intended as the sole source of information. Instead, it was contemplated that detailed agency fiscal regulations would supply detailed funding information and procedures.<sup>57</sup> There is no guidance in the FAR concerning when full funding, as opposed to incremental funding is appropriate.

It is interesting to note that this FAR subpart contains no definitions of the terms used, although many were proposed and definitions for such terms as "fully funded

contract" and "incrementally funded contract" were included in the FAR Phase II spreadsheets for FAR 32.701, which was reserved in the final version. It was proposed to define a fully funded contract as "a contract in which sufficient funds are available and are allotted to the contract at the time of contract award," while an incrementally funded contract was proposed to be defined as one "in which the total work effort is to be performed over multiple time periods and funds are allotted to cover discernable phases or increments of performance."<sup>58</sup>

Not every contract in which "expenditure authority" lags behind "obligational authority is considered incrementally funded. Contracts entered into on the basis of express contract authority, such as domestic contracts implementing Foreign Military Sales (FMS) contracts as noted previously, do not require clauses either conditioning the government's obligation on availability of funds, or limiting the government's obligation to particular costs figures. When express contract authority is used, the fiscal control laws are not violated by contracting before or above available funds because such contracts are "otherwise authorized by law" and neither contractors nor contracting officers require the protections intended by such limiting clauses. It was decided, as a policy matter, to omit such clauses in Air Force FMS contracting because no basis was seen



for an allegation that the contractor has been misled by failure of the Air Force to 'fully and accurately disclose the true status of available funds.' Section 22 of the [Arms Export Control Act] is very clear and the contractor is presumed to know the law. Any attempt to limit the liability of the USG and the remedies of the contractor, as proposed by AFSC, would cause more problems than it would solve. It seems probable that many contractors would refuse to sign a contract which contained such limitations, or would seek to cover what they would perceive as additional risks by contingency reserves or other price increases. Accordingly, this office is of the opinion that additional contract clauses along the lines proposed by AFSC are neither required or desirable.<sup>59</sup>

## 2. Former DAR Provisions

The DAR covered contracts conditional on funds availability in DAR 1-318; and incrementally funded contracts in DAR 1-2001, 7-203.3(b), and 7-402.2(c) and (d).

DAR 1-2001 required contracting officers using cost reimbursement type contracts to assure that adequate funds were available at all times to cover the estimated cost and fee (if any) in fully funded contracts, or in the case of incrementally funded contracts, to cover the amount allotted to the contract and any corresponding increment of fee (if any).

DAR 7-203.3(b) required a Limitation of Cost clause in all fully funded cost-reimbursement type supply contracts, and

DAR 7-203-3(d) required the DAR 7.104.91 Availability of Funds clause also be used when funds were not yet available for the contract at the time of award.

DAR 7-402.2 (c) and (d) required different Limitation of Funds clauses for incrementally funded cost-reimbursement type R&D contracts of the cost-sharing and non-cost-sharing varieties.

### **3. Availability of Funds Clauses**

The FAR permits limited conditional contracting, but requires use of an Availability of Funds clause when adequate funds are not available at the time of contracting, to prevent Antideficiency Act violations. These clauses may only be used with operation and maintenance and continuing services contracts, and indefinite quantity or requirements contracts funded with annual funds. Use of a Limitation of Cost clause is required for fully funded cost reimbursement contracts, and a Limitation of Funds Clause is required for incrementally funded cost reimbursement contracts to protect the government and contractors from the effects of Antideficiency Act violations.

Two Availability of Funds clauses are prescribed for contracting conditionally in advance of funds. Contracting

officers are permitted to begin contracting actions for contracts anticipated to be chargeable to the next year's annual funds before they become available. This is a common technique used to avoid the delays and disruption that would occur if the contracting process could only be begun after appropriation, apportionment and administrative subdivision of funds. The FAR provides that such contracts may be made expressly conditional upon the future availability of funds by use of the Availability of Funds clause:

Funds are not presently available for this contract. The Government's obligation under this contract is contingent upon the availability of appropriated funds from which payment for contract purposes can be made. No legal liability on the part of the Government for any payment may arise until funds are made available to the Contracting Officer for this contract and until the Contractor receives notice of such availability, to be confirmed in writing by the Contracting Officer.<sup>60</sup>

This authority is limited to operation and maintenance and continuing services, such as rentals, utilities and supply items not financed by stock funds, which are necessary for continuation of normal operations and for which Congress "previously had consistently appropriated funds, unless specific statutory authority exists permitting applicability to other requirements."<sup>61</sup> This last cryptic phrase was added at the suggestion of the Department of the Interior to accommodate contracts such as its construction contracts authorized under 43 U.S.C. § 388, the Reclamation Project

Act.<sup>62</sup> The Operation and Maintenance appropriation is funded with annual funds. This authority restriction in the FAR, the DAR and the ASPR has restricted conditional contracting to contracts using annual funds.

To avoid Antideficiency Act violations, the Air Force prohibits delivery or notification of contract awards that are not within this FAR authority for contracts chargeable to the next fiscal year's funds. The purchase request may be processed, the resulting contractual documents may be signed and approved but may not be distributed, nor notice of award given, until the servicing Air Force Accounting and Finance Office (AFO) furnishes an allotment citation and certification of funds availability.<sup>63</sup>

The second clause for contracting conditionally in advance of funds is prescribed for one-year indefinite quantity or requirements contracts for goods and services funded with annual funds. Such contracts are permitted by the FAR to extend beyond the fiscal year in which they begin if any specified minimum quantities are certain to be ordered in the initial fiscal year, and the Availability of Funds for the Next Fiscal Year clause is used:<sup>64</sup>

Funds are not presently available for performance under this contract beyond \_\_\_\_\_. The Government's obligation for performance of this contract beyond that date is contingent upon the

availability of appropriated funds from which payment for contract purposes can be made. No legal liability on the part of the Government for any payment may arise for performance under this contract beyond \_\_\_\_\_, until funds are made available to the Contracting Officer for performance and until the Contractor receives notice of availability, to be confirmed in writing by the Contracting Officer.<sup>65</sup>

In both cases, agencies are explicitly prohibited from accepting goods or services under conditional contracts until after the contracting officer has given the contractor written notice of funds availability. Conversely, the contractor has no right to begin work until this notice of funds availability is received, and he may not unilaterally create a government obligation by doing so.<sup>66</sup> This restriction is intended to prevent the government from becoming obligated under an implied-in-fact contract.<sup>67</sup>

The FAR provides that, without express statutory authority, contracts funded with annual funds may not cross fiscal years, unless the contract is "for an end product that cannot feasibly be subdivided for separate performance in each fiscal year," such as expert or consultant services contracts.<sup>68</sup>

The GAO, in its comments on the Phase I FAR, recommended deletion of FAR 703-2(b) and the Availability of Funds for the Next Fiscal Year clause on the basis that no

Leiter affirmative act was required that would compel agencies to create a new obligation in the next fiscal year:

While we recognize that this proposed section is basically a revision of DAR 1-318 (b), it is our view that the section is contrary to the prohibitions contained in 31 U.S.C. [§§ 1341, 1502 and 3324]. Our Office and the courts have held that the mere presence of an 'Availability of Funds' clause does not lend validity to a contract funded with an annual appropriation which crosses fiscal year lines. Leiter v. United States, . . . ; Burroughs Corporation, 56 Comp. Gen. 142, 153 (1976), . . . ; 42 Comp. Gen. 272 . . . . It is necessary to provide an affirmative duty for the agency to extend the contract into the next fiscal year. In the absence of such a duty the contract must be considered terminated at the end of the initial fiscal year. Accordingly, we recommend that the section be revised to indicate that, in the absence of specific legislative authority, no contract for goods or services may cross fiscal year lines. Similarly, we recommend that the 'Availability of Funds for Next Fiscal Year clause' . . . be deleted.<sup>69</sup>

The FAR Project Office deferred these comments to the FAR Council on the rationale that this portion of the FAR was based on DAR 1-318, "Contracts Conditioned on Availability of Funds," and the FAR Project Office did not have authority to change current DAR policy.<sup>70</sup>

DAR 1-318 provided:

(a) Fiscal Year Contracts. To effect procurements promptly upon the beginning of a new fiscal year, it may at times be necessary to initiate a procurement properly chargeable to funds of the new fiscal year prior to the availability of such funds. In such instances, the clause in

7-104.91(a) shall be included in the contract. This authority shall be used only for operation and maintenance and continuing services (such as rentals, utilities, and items of supply which are not financed by stock funds) which are necessary for normal operation and for which the Congress consistently appropriates funds.

(b) Contracts Crossing Fiscal Years. A one-year requirements or indefinite quantity contract for services funded by annual appropriations may extend beyond the end of the fiscal year current at the beginning of the contract term provided that any specified minimum quantities are certain to be ordered in the fiscal year current at the beginning of the contract term (see 22-107). In this case, the clause in 7-104.91(b) shall be included in the contract. Also, a contract for expert or consultant services entered into in accordance with 22-204.2 and calling for an end product which cannot feasibly be subdivided for separate performance in each fiscal year may cross fiscal years.

(c) Acceptance of Supplies or Services. When either of the Availability of Funds clauses is used, the supplies or services shall not be accepted by the Government until funds are available to the contracting officer for the procurement and until the contracting officer has given notice to the contractor (to be confirmed in writing) of such availability. Records will be maintained to insure adequate administrative control of funds.

Despite the GAO's objections, the FAR provisions and the former DAR provision are very similar. The express limitation of any government obligation until after written notice of funds availability (and impliedly, of renewed government intent to be bound) is furnished by the Contracting Officer should satisfy the the Leiter affirmative act requirement.

#### 4. Limitation of Costs Clauses

The FAR prescribes several clauses to achieve limitation of cost or funds (LOC or LOF clauses) in FAR 32.705-2. One LOC clause is required for fully funded cost reimbursement contracts generally, and another for fully funded cost reimbursement contracts for "consolidated facilities, facilities acquisition or facilities use."<sup>71</sup> The LOF clause is required for incrementally funded cost-reimbursement contracts.

The LOC clauses place a heavy burden on contractors to maintain accounting systems adequate to permit contractors to manage their contracts well enough to avoid exceeding the LOC's funding limit and to fulfill their contractual duty to notify the government when their contracts' funding limits are reached. Funds or cost limitation clauses are intended to help prevent overruns, to implement budget controls to avoid deficiency or supplemental appropriation requests. It is worth noting that giving the required notice of approaching the stated funding limit does not entitle the contractor to funding of cost overruns. As the clause clearly states, the government has the discretionary choice to allocate more funds to the contract (if available and in the government's best interest to continue the contract) or to halt the work and terminate the contract. The contractor is not obligated to



continue the work or to continue to incur costs under the contract and, further, he may not unilaterally impose greater obligations on the government by continuing performance or incurring costs after the cost limit has been reached.<sup>72</sup>

The general LOC clause for use in fully funded cost-reimbursement contracts states:

(a) The parties estimate that performance of this contract, exclusive of any fee, will not cost the Government more than (1) the estimated cost specified in the Schedule or, (2) if this a cost-sharing contract, the Government's share of the estimated cost specified in the Schedule. The Contractor agrees to use its best efforts to perform the work specified in the Schedule and all obligations under this contract within the estimated cost, which, if this is a cost-sharing contract, includes both the Government's and the Contractor's share of the cost.

(b) The Contractor shall notify the Contracting Officer in writing whenever it has reason to believe that --

(1) The costs the contractor expects to incur under this contract in the next 60 days, when added to all costs previously incurred, will exceed 75 percent of the estimated cost specified in the Schedule; or

(2) The total cost for the performance of this contract, exclusive of any fee, will be either greater or substantially less than had been previously estimated.

(c) As part of the notification, the Contractor shall provide the Contracting Officer a revised estimate of the total cost of performing this contract.

(d) Except as required by other provisions of this contract, specifically citing and stated to be an exception to this clause --

(1) The Government is not obligated to reimburse the Contractor for costs incurred in excess of (i) the estimated cost specified in the Schedule or, (ii) if this is a cost-sharing contract, the estimated cost to the Government specified in the Schedule; and

(2) The Contractor is not obligated to continue performance under this contract (including actions under the Termination clause of this contract) or otherwise incur costs in excess of the estimated cost specified in the Schedule, until the Contracting Officer (i) notifies the Contractor in writing that the estimated cost has been increased and (ii) provides a revised estimated total cost of performing this contract. If this is a cost-sharing contract, the increase shall be allocated in accordance with the formula specified in the Schedule.

(e) No notice, communication, or representation in any form other than that specified in subparagraph (d)(2) above, or from any person other than the Contracting Officer, shall affect this contract's estimated cost to the Government. In the absence of the specified notice, the Government is not obligated to reimburse the Contractor for any costs in excess of the estimated cost or, if this is a cost-sharing contract, for any costs in excess of the estimated cost to the Government specified in the Schedule, whether those excess costs were incurred during the course of the contract or as a result of termination.

(f) If the estimated cost specified in the Schedule is increased, any costs the Contractor incurs before the increase that are in excess of the previously estimated cost shall be allowable to the same extent as if incurred afterward, unless the Contracting Officer issues a termination or other notice directing that the increase is solely to cover termination or other specified expenses.

(g) Change orders shall not be considered an authorization to exceed the estimated cost to the Government specified in the Schedule, unless they contain a statement increasing the estimated cost.

(h) If this contract is terminated or the estimated cost is not increased, the Government and the Contractor shall negotiate an equitable

distribution of all property produced or purchased under the contract, based upon the share of costs incurred by each.<sup>73</sup>

The special LOC clause for use in contracts for consolidated facilities, facilities acquisition, or facilities use provides:

(a) The parties estimate that performance of this contract will not cost the Government more than the estimated cost specified in the Schedule. The Contractor agrees to use its best efforts to perform the work specified in the Schedule within the estimated cost.

(b) The Contractor shall notify the Contracting Officer in writing whenever it has reason to believe that --

(1) The costs that the Contractor expects to incur under this contract in the next 30 days, when added to all costs previously incurred, will exceed 85 percent of the estimated cost specified in the Schedule; or

(2) The total cost to the Government for the performance of this contract will be either greater or substantially less than had previously been estimated.

(c) As part of the notification, the Contractor shall provide the Contracting Officer a revised estimate of the total cost of performing this contract.

(d) Except as required by other provisions of this contract, specifically citing and stated to be an exception to this clause --

(1) The Government is not obligated to reimburse the contractor for costs incurred in excess of the estimated cost specified in the Schedule; and

(2) The Contractor is not obligated to continue performance under this contract (including actions under the Termination clause of this contract) or otherwise incur costs in excess of

the estimated cost specified in the Schedule, until the Contracting Officer (i) notifies the Contractor in writing that the estimated costs has been increased and (ii) provides a revised estimated total cost of performing this contract.

(e) No notice, communication, or representation in any form other than that specified in subparagraph (d)(2) above, or from any person other than the Contracting Officer, shall affect this contract's estimated cost to the Government. In the absence of the specified notice, the Government is not obligated to reimburse the Contractor for any costs in excess of the estimated cost, whether those excess costs were incurred during the course of the contract or as a result of termination.

(f) If the estimated cost specified in the Schedule is increased, any costs the Contractor incurs before the increase that are in excess of the previously estimated cost shall be allowable to the same extent as if incurred afterward, unless the Contracting Officer issues a termination or other notice directing that the increase is solely to cover termination or other specified expenses.

(g) Change orders shall not be considered an authorization to exceed the estimated cost to the Government specified in the Schedule, unless they contain a statement increasing the estimated cost.<sup>74</sup>

The difference between the clauses lies in the deletion of the cost-sharing language, and the specification of the 30-day notice period for approach of the 85 per cent limit. Unlike the general LOC clause, there is no provision for varying the 30-day or 85 per cent limit. The limits in the general LOC clause can be varied between 30 to 90 days and 75 to 85 per cent.

## 5. Limitation of Funds Clause

The Limitation of Funds clause specified by the FAR to be used in incrementally funded cost reimbursement contracts reads:

(a) The parties estimate that performance of this contract will not cost the Government more than (1) the estimated cost specified in the Schedule or (2) if this is a cost-sharing contract, the Government's share of the estimated cost specified in the Schedule. The Contractor agrees to use its best efforts to perform the work specified in the Schedule and all obligations under this contract within the estimated cost, which, if this a cost-sharing contract, includes both the Government's and the Contractor's share of the cost.

(b) The Schedule specifies the amount presently available for payment by the Government and allotted to this contract, the items covered, the Government's share of the cost if this is a cost-sharing contract, and the period of performance it is estimated the allotted amount will cover. The parties contemplate that the Government will allot additional funds incrementally to the contract up to the point at which the total amount paid and payable by the Government under the contract approximates but does not exceed the total amount actually allotted by the Government to the contract.

(c) The Contractor shall notify the Contracting Officer in writing whenever it has reason to believe that the costs it expects to incur under this contract in the next 60 days, when added to all costs previously incurred, will exceed 75 percent of (1) the total amount so far allotted to the contract by the Government or, (2) if this is a cost-sharing contract, the amount then allotted to the contract by the Government plus the Contractor's corresponding share. The notice shall state the estimated amount of additional funds required to continue performance for the period specified in the Schedule.

(d) Sixty days before the end of the period specified in the Schedule, the Contractor shall notify the Contracting Officer in writing of the estimated amount of additional funds, if any, required to continue timely performance under the contract or for any further period specified in the Schedule or otherwise agreed upon, and when the funds will be required.

(e) If, after notification, additional funds are not allotted by the end of the period specified in the Schedule or another agreed upon date, upon the Contractor's written request the Contracting Officer will terminate this contract on that date in accordance with the provisions of the Termination clause of this contract. If the Contractor estimates that the funds available will allow it to continue to discharge its obligations beyond that date, it may specify a later date in its request, and the Contracting Officer may terminate this contract on that later date.

(f) Except as required by other provisions of this contract, specifically citing and stated to be an exception to this clause --

(1) The Government is not obligated to reimburse the Contractor for costs incurred in excess of the total amount allotted by the Government to this contract; and

(2) The Contractor is not obligated to continue performance under this contract (including actions under the Termination clause of this contract) or otherwise incur costs in excess of (i) the amount then allotted to the contract by the Government or, (ii) if this is a cost-sharing contract, the amount then allotted by the Government to the contract plus the Contractor's corresponding share, until the Contracting Officer notifies the Contractor in writing that the amount allotted by the Government has been increased and specifies an increased amount, which shall then constitute the total amount allotted by the Government to this contract.

(g) The estimated cost shall be increased to the extent that (1) the amount allotted by the Government or, (2) if this is a cost-sharing contract, the amount then allotted by the Government to the contract plus the Contractor's corresponding share, exceeds the estimated costs specified in the

Schedule. If this is a cost-sharing contract, the increase shall be allocated in accordance with the formula specified in the Schedule.

(h) No notice, communication, or representation in any form other than that specified in subparagraph (f)(2) above, or from any person other than the Contracting Officer shall affect the amount allotted by the Government to this contract. In the absence of the specified notice, the Government is not obligated to reimburse the Contractor for any costs in excess of the total amount allotted by the Government to this contract, whether incurred during the course of the contract or as a result of termination.

(i) When and to the extent that the amount allotted by the Government to the contract is increased, any costs the Contractor incurs before the increase that are in excess of (1) the amount previously allotted by the Government or, (2) if this is a cost-sharing contract, the amount previously allotted by the Government to the contract plus the Contractor's corresponding share, shall be allowable to the same extent as if incurred afterward, unless the Contracting Officer issues a termination or other notice and directs that the increase is solely to cover termination or other specified expenses.

(j) Change orders shall not be considered any authorization to exceed the amount allotted by the Government specified in the Schedule, unless they contain a statement increasing the amount allotted.

(k) Nothing in this clause shall affect the right of the Government to terminate this contract. If this contract is terminated, the Government and the Contractor shall negotiate an equitable distribution of all property produced or purchased under the contract, based upon the share of costs incurred by each.

(i) If the Government does not allot sufficient funds to allow completion of the work, the Contractor is entitled to a percentage of the fee specified in the Schedule equalling the percentage of completion of the work contemplated by this contract.<sup>75</sup>

Sometimes contractors have recovered costs in excess of the stated funding limits, even though the LOF clause makes allowability expressly contingent on subsequent allotment of additional funds. Excess costs have been allowed where -- after the funding limit notice was given -- the government stressed the procurement's urgency, invited or induced unfunded performance, administered the contract, and accepted the goods or services. The clause is not to be used to obtain the contractor's performance without just and fair compensation.<sup>76</sup>

#### **6. Action Required When Funding Limit Reached**

When either of the LOC or LOF clauses is used, the contracting officer is required to take one of four alternative actions upon learning from the contractor that he is nearing either the estimated cost or the limit of funds allotted to the contract after "promptly" obtaining relevant funding and programming information. In accordance with FAR 32.704 (b), he must notify the contractor in writing that either

(i) Additional funds have been allotted, or the estimated cost has been increased, in a specified amount;

(ii) The contract is not to be further funded and that the contractor should submit a proposal for an adjustment of fee, if any, based on the percentage of work completed in relation to the



total work called for under the contract;

(iii) The contract is to be terminated; or

(iv) (A) The Government is considering whether to allot additional funds or increase the estimated cost, (B) the contractor is entitled by the contract terms to stop work when the funding or cost limit is reached, and (C) any work beyond the funding or cost limit will be at the contractor's risk.<sup>77</sup>

When a contracting officer learns an incrementally funded contract will receive no further funds, he is required to promptly give written notice of the decision not to provide funds,<sup>78</sup> even before learning the contractor is nearing funding limits.

The FAR permits contracting officers to issue change orders, directions to replace or repair defective items or work, or termination notices without previously increasing the funds available under the contract but, because contractors are not required under the LOC or LOF clauses to incur any costs over the contract's estimated cost, contracting officers must be sure adequate funds are available or made available. They may specify that any increases be devoted solely to specific expenses, such as termination.

Although these clauses permit contractors to proceed with performance after exhaustion of funds, the regulation attempts to state clearly that if they do so they perform at their own risk that adequate funds may not later be provided

to reimburse their efforts. The FAR also clearly states that the Antideficiency Act's prohibition against accepting volunteer, as opposed to gratuitous, work:

Government personnel encouraging a contractor to continue work in the absence of funds will incur a violation of [31 U.S.C. § 1342] that may subject the violator to civil or criminal penalties.<sup>79</sup>

Agencies must take care not to appear to tacitly encourage such voluntary risks.<sup>80</sup>

The FAR also states the general prohibition of the Antideficiency Act: "No officer or employee may create or authorize an obligation in excess of the funds available, or in advance of appropriations." Further, contracting officers, before executing any contract are required either (1) to secure "written assurance from responsible fiscal authority that adequate funds are available," or (2) to "expressly condition the contract upon availability of funds."<sup>81</sup>

## 7. Obligation of Funds

Agencies are required to obligate differing amounts in the cases of fully funded or incrementally funded contracts. For fully funded contracts, sufficient funds must be obligated to "cover the price or target price of a fixed price contract or the estimated costs and any fee of a cost-reimbursement

contract," while incrementally funded contracts require obligating only enough funds "to cover the amount allotted and any corresponding increment of fee." The FAR, then, requires obligating sufficient funds to meet the government's entire obligations under each of its contracts.<sup>82</sup> Since termination costs are normally less than these amounts, no additional termination reserve would be required, but the FAR does not preclude such an additional reservation.

One objection to the Phase I FAR's failure to specifically require an additional termination reservation was that if the government does not reserve funds in cost reimbursement contracts for unavoidable termination costs, such as layoff income benefits for terminated employees or relocation to home base of any field forces, then contractors might do so, resulting in a contractor reservation of large shares of allotted funds. To this objection, the FAR Project Office replied:

The Government generally funds termination liability only on an undefinitized contract. Once definitized, if contract termination occurs, the language of FAR 32.704 (b) governs,"<sup>83</sup>

which provides that contractors need not incur termination costs in excess of funds allotted.

Thus, current policy is that "contract costs, together with termination liability, do not exceed the funds allotted to the contract."<sup>84</sup> On the other hand, there are some termination liabilities that are so remote they are classed as truly contingent liabilities, and are unfunded and unreserved: these DOD has permitted to be guaranteed under the Special Termination Costs clause.

### 8. Special Termination Costs Clause

The DAR provided the Special Termination Costs clause to permit the government to extract performance within allotted funds up to the limits of costs which would only be incurred in the event of a contract termination.<sup>85</sup> The theory was that additional contract performance could be obtained without the obligation of additional funds on some large incrementally funded contracts -- in which it had been determined that termination was very unlikely -- if the contractor was required to exclude from his contract cost estimate (notwithstanding the contract's LOF clause) certain costs which would only be incurred by the government in the unlikely event of a termination. This would make more allotted funds available for contract performance.

These costs were thought to be true contingent liabilities, not constituting "obligations" until the

contingency (termination) actually occurred, for which funds are not required to be either obligated or reserved. This limited class of costs, denominated "special" termination costs, included severance pay, reasonable costs continuing after termination, settlement expenses, and costs of return of field service personnel from work sites. Under the clause, the parties negotiated a liquidated sum which served as a ceiling on contractor recovery for these costs in the event of termination.

There is no corresponding FAR provision, but DOD has continued the clause in its FAR Supplement 49.7003 which restricts the clause to use in any incrementally funded contracts with a term of 2 or more years, estimated to require total RDT&E funding over \$25 million or total production investment over \$100 million. The existence of adequate appropriations to cover the "contingent reserved liability" for special termination costs in the event of contract termination is required and approval of use of the Special Termination Costs clause must occur at the Department Secretary level, as before.

The DOD FAR Supplement Special Termination Costs clause provides:

(a) 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 for 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 return of field service 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.

(b) In the event of termination for the convenience of the Government, this clause shall not be construed as affecting the allowability of special termination costs in any manner other than limiting the maximum amount payable therefore by the Government.

(c) This clause shall remain in full force and effect until this contract is fully funded.<sup>86</sup>

The clause is not considered an improper augmentation of appropriations because these particular costs would only be incurred in the event of termination of the contract -- they do not contribute to the completion of the contract (the

purpose for which funds were appropriated), and the contractor's obligation to complete performance at the agreed price is unaffected by this clause.<sup>87</sup> As long ago as 1973, the Senate Armed Forces Committee approved use of this clause and urged wider use.<sup>88</sup> Because of the full funding policy applied to procurement programs, special termination costs clauses have almost exclusively been used in R&D programs funded with RDT&E funds.

### **C. Indefinite Delivery Contracts And Related Contractual Devices**

Other ways to meet government agencies' needs to maintain reasonably certain activity levels with time-limited funds across fiscal year periods are to use indefinite delivery contracts, to negotiate interim letter contracts, or to rely upon previously negotiated Basic Agreements or Basic Ordering Agreements. Letter contracts authorize immediate performance, with the parties contemplating later agreement upon a definitive contract. Basic Agreements and Basic Ordering Agreements are not contracts in themselves but, by resolving in advance many issues concerning future contracts, they facilitate later swift completion of formal contracts.

## 1. Definite, Indefinite, and Requirements Contracts

Indefinite delivery contracts include definite quantity, indefinite quantity and requirements contracts. Definite quantity contracts obligate the government for known quantities of goods or services, leaving the time or place of performance for later specification. If more than the current fiscal year's needs were ordered under a definite quantity contract founded only on the implied contract authority of annual funds, violations of the bona fide needs rule and various fiscal control statutes would occur. Requirements contracts founded on the implied contract authority of annual funds similarly would violate these fiscal law rules, to the extent they purported to obligate or to create the possibility of obligation of the government beyond the period of availability limitation or before funds became available. Likewise, indefinite quantity contracts are fiscally objectionable, even when entered into solely on the implied authority of annual funds, if the government could become obligated beyond or before the availability of funds under such contracts.

Indefinite quantity contracts have been described as specialized forms of options contracts, because the government acquires the right to require more of the subject supplies or services at some determined or determinable, limited price.



Option contracts, in ASPR/DAR usage, were prescribed for advertised or negotiated procurement of goods not readily available in the market when needs beyond the minimum were foreseeable, but not firm or definite, and where factors such as lead times, startup or transportation costs could later prevent adequate recompetition. Indefinite quantity contracts were prescribed for use only in negotiated procurements of commercial or modified commercial supplies or services, in which initial orders for greater quantities might not be expected to greatly lower costs or prices since factors such as startup or minimum economic production quantities would be less important.<sup>89</sup>

At times it has not been an easy task to categorize indefinite delivery contracts. Contracts committing the government to purchase no stated minimum quantity over the five-year contract period, but stating instead estimated quantities, and omitting the Limitation of Price and Contractor Obligations clause required for multiyear contracts, have been classed as a "multiyear requirements" contract. Under one such contract, the government's failure to order the estimated minimum quantities did not amount to a partial termination for convenience, and the contractor was not entitled to recover more for nonrecurring startup costs because it had already fully recouped these costs under its method of recoupment calculation spreading these costs over

the Best Estimated Quantities (BEQ's), when the BEQ's had been ordered before termination.<sup>90</sup>

The difficulty with requirements contracts funded with annual funds is exemplified by the Comptroller's 1964 ruling in the Wake Island case,<sup>91</sup> in which the Comptroller held that any contract using annual funds that involved the government in "any type of obligation whether fiscal or promissory beyond the period of funding availability" binds the government only through the end of the first fiscal year.<sup>92</sup> In this case, the Air Force had sought three years of supplies and services needed to accommodate transiting aircraft, and annual funds were to be used to buy the services because this was plainly an operation and maintenance activity. Even though funds are generally not obligated under requirements contracts until orders are placed, the Comptroller decided that a promise to buy future years' needed services must violate the bona fide needs rule, which requires that only the actual needs of each year may be procured with that year's appropriations, 41 U.S.C. § 11, the Antideficiency Act and then 31 U.S.C. § 712a (now § 1502). The Comptroller found that the only authority for entering this contract derived from the annual appropriations used and, accordingly, all the limitations associated with the time-limited annual appropriations were necessarily applied. The Comptroller stated those statutes -- in addition to protecting the integrity of funds

availabilities -- also

prohibit contractual agreements under fiscal year appropriations which involve the government beyond such period of availability not only in appropriation obligations, but any other obligation or liability which may arise thereunder and ultimately require the expenditure of funds.<sup>93</sup>

Contracts based solely on the implied authority of time-limited annual appropriations are construed to bind the government only to the limit of the fiscal year current at the time the contract is entered and, even when the contract renewal is made contingent upon the availability of funds, the Comptroller follows the rule that renewal requires a Leiter affirmative act in the new fiscal year, in effect making a new contract. The Comptroller has recognized that recompetition should not be required where it would be futile or counterproductive.<sup>94</sup> Thus, in the Wake Island case, the crucial factor was that the Comptroller found little contracting officer control over incurrence of new obligations under that contract, since requirements and authority to perform to meet them purportedly arose automatically upon the arrival of aircraft. This feature of the contract not only created the possibility of obligations beyond the availability of the appropriation used, but also created the possibility that current obligations might be overobligated.<sup>95</sup>

The need to contract with annual funds for the needs of subsequent fiscal years can be partly met with indefinite quantity contracts, if care is taken to obligate funds only for the minimum bona fide needs of the then current fiscal year, and the government is not obliged under the contract to place orders for subsequent fiscal years.<sup>96</sup> However, indefinite quantity contracts do not wholly satisfy the government's need to secure goods or services at the lowest possible price. From the contractor's perspective, indefinite quantity contracts are even less certain than requirements contracts because not all the stated requirements need be procured from that contractor and it must either price in a contingency factor to take into account the possibility that no work beyond the stated minimum will be ordered, or else assume this considerable risk.<sup>97</sup> Further limitations on the use of indefinite quantity contracts are that they may only be used when the quantity of goods and services cannot be forecast certainly, and the FAR states they "should be used only for items or services that are commercial products or commercial-type products and when a recurring need is anticipated."<sup>98</sup>

In 1966, the fiscal law problems associated with the use of annual funds and indefinite delivery contracts and suggested solutions were summarized this way:

## INDEFINITE DELIVERY CONTRACTS

These fall into four categories:

First, Definite Quantity contracts where everything is firm except where the delivery or performance is to be. These may be funded with current year funds. If Annual funds are involved and it is desired to cross fiscal year lines with the performance period, we are faced with the Wake Island decision. It has been suggested that the Conditional Contract clause of ASPR 1-318 is the solution; however, until the Comptroller General is presented with such a case, it is suggested that options be used to extend the contract, or that two contracts be used: one for the current year and another, possibly a Conditional contract, for the new year.

Second, Requirements contracts which have a maximum and minimum quantities proviso and the Government agrees to purchase all actual requirements for a specified period. Funding should be for the minimum quantity and use the then current year funds for calls after the contract minimum is exceeded.

Third, Indefinite Quantities contracts in which maximums and minimums are provided for and delivery is to be as ordered by the contracting officer. This contract should be funded for the minimum. Any requirement above the minimum should be funded with monies of the year of the order.

Fourth, Call Procurement Arrangement when no minimum or maximum is provided for and quantity and delivery is to be as called for by the contracting officer. From a legal viewpoint, this is the least desirable type of procurement because there is really no contract until a call is issued. But from the funding viewpoint, it eliminates the problem of crossing fiscal years with annual funds, as funds current at the time the call is issued will be used.<sup>99</sup>

This commentator suggested that when annual funds are used, as they must be with operation and maintenance activities, definite quantity contracts might be legally entered if the DAR 1-318 conditional contract clause was used,

but he counselled against such an untested course, leaning instead toward use of options or separate contracts for each fiscal year with subsequent years being made conditional on availability of funds.

DAR 3-409 provided for three types of indefinite quantity contracts.<sup>100</sup> They could be fixed price contracts, or provide for economic price adjustment, price redetermination, or prices to be established by an adjustment factor based on catalog or market prices. Definite quantity contracts were to be used when the amounts of goods or services needs were known at time of contracting, but the location of performance was not yet known. Requirements contracts were considered suitable when goods or services were "commercial or modified commercial," to fill all requirements of identified agency activities. Funds were to be obligated upon placement of each order, "and not by the contract itself." Estimated total quantities were to be stated, as were estimated maximum and minimum quantities, for the information of prospective contractors. Indefinite quantity contracts were limited to use when the goods or services were commercial or modified commercial. Firm, more than nominal, minimum quantities and estimated maximum quantities were required to be stated. Such contracts were to be used when the precise quantities needed during a definite time could not be fixed in advance and it was therefore "not advisable for

the Government to commit itself for more than a minimum quantity." Funds were to be obligated immediately for the stated minimum quantity, but otherwise only on placement of orders under the contract.

The DAR, in 22-107 (a), permitted service contracts funded with annual appropriations to cross fiscal years if they fell into one of these categories:

(1) a one-year contract for maintenance of tools or facilities if authorized under the current Department of Defense Appropriations Act;

(2) a multi-year service contract within the coverage of 1-322.6;

(3) a one-year requirements or indefinite quantity contract, . . . in which any specified minimum quantities are certain to be ordered in the fiscal year current at the beginning of the contract term (see 1-318), and containing the DAR 77-104.91 (b) availability of funds clause; or

(4) a contract for expert or consultant services entered into in accordance with 22-204.2, or for educational services, which cannot feasibly be subdivided for separate performance in each fiscal year.

The FAR authorizes the same three types of indefinite delivery contracts in Subpart 16.5, stating "[t]he appropriate type of indefinite delivery contract may be used when the exact times and/or quantities of future deliveries are not known at the time of contract award.

FAR 16.502 limits definite-quantity contracts -- in which definite quantities are to be delivered at locations later to be scheduled by orders -- to cases when definite quantities can be specified in advance, and the supplies or services either are regularly available or will be regularly available after a short lead time.

FAR 16.503 prescribes requirements contracts -- in which all actual purchase requirements of designated activities are to be supplied by the contractor, as later to be scheduled by orders -- when recurring requirements for commercial or commercial-type products are anticipated and precise quantities cannot be determined in advance. "Commercial products" are those sold or traded to the general public at prices based on established catalog or market prices, while "commercial-type products" are either modified to meet some physical or other requirement peculiar to the government or otherwise somehow identified differently from their commercial counterparts.<sup>101</sup> Realistic estimated total quantities must be stated, as must the maximum limit of the contractor's obligation, if this may be done feasibly. Maximum or minimum quantities per order or during a specified time may also be stated.

FAR 16.504 permits indefinite-quantity contracts -- in which a limited, but unknown, quantity is to be supplied as



later to be scheduled by orders -- when precise quantities cannot be forecast and "it is inadvisable for the Government to commit itself for more than a minimum quantity." These contracts must require the government to buy some stated, more than nominal, minimum quantity, and must state some realistic maximum contractor obligation. Maximum and minimum quantities per order or during a stated time may also be included.

Consideration for requirements contracts is furnished by the government's promise to purchase all its stated requirements from that contractor, if it has any requirements. Consideration for indefinite quantity contracts is furnished by the non-nominal minimum quantity stated. This consideration prevents such contracts from failing for lack of mutuality of obligation. Whether the stated minimum quantity supplies consideration for both the contractor's promises to supply that quantity as well as additional, but indefinite quantities has been litigated, but apparently not resolved.

An early Supreme Court case decided that an indefinite quantity contract stating no required minimum quantity purchase was unenforceable initially, but became enforceable to the extent performed, even though performance was under protest. This reasoning has been followed by the Court of Claims, although the Armed Services Board has held indefinite quantities contracts stating non-nominal minimums to be

enforceable in their entireties. To resolve this issue would require a case in which a contractor flatly refused to perform as to quantities over the minimum quantity stated, running the risk of default and excess reprourement expenses.<sup>102</sup>

With requirements contracts, in which the contractor is promised no set minimum quantity but is asked to base its offer on an estimated quantity, the contractor assumes the risk of fluctuating actual requirements. Relief has been granted in cases in which the government estimate was not prepared with due care and was so grossly incorrect that it constituted an misrepresentation on which the contractor relied to its detriment.<sup>103</sup> But with indefinite quantity contracts, the contractor is guaranteed a stated minimum quantity and the government may order more -- either under the contract or from other sources -- and the contractor assumes the risk in setting its unit price and bidding on indefinite quantity contracts that no more than the minimum quantity may be ordered.<sup>104</sup> In both cases, funds are obligated as delivery orders are placed rather than when the contract is formed, because the extent of the government's obligation cannot be known in advance. For this reason, use of indefinite quantity and requirements contracts is encouraged, as they tend to preserve management flexibility in the use of obligational authority through the authorized obligation period.<sup>105</sup>

When either requirements, definite-quantity or indefinite-quantity contracts are used, the Ordering clause must be included:

(a) Any supplies and services to be furnished under this contract shall be ordered by issuance of delivery orders by the individuals or activities designated in the Schedule. Such orders may be issued from \_\_\_\_\_ through \_\_\_\_\_ [insert dates]

(b) All delivery orders are subject to the terms and conditions of this contract. In the event of conflict between a delivery order and this contract, the contract shall control.

(c) If mailed, a delivery order is considered 'issued' when the Government deposits the order in the mail. Orders may be issued orally or by written telecommunications only if authorized in the Schedule.<sup>106</sup>

A clause "substantially the same as" the Delivery Orders Limitations clause also must be used:

(a) Minimum order. When the Government requires supplies or services covered by this contract in an amount of less than \_\_\_\_\_ [insert dollar figure or quantity], the Government is not obligated to purchase, nor is the Contractor obligated to furnish, those supplies or services under the contract.

(b) Maximum order. The Contractor is not obligated to honor --

(1) Any order for a single item in excess of \_\_\_\_\_ [insert dollar figure or quantity];  
or

(2) Any order for a combination or items in excess of \_\_\_\_\_ [insert dollar figure of quantity]; or

(3) A series of orders from the same ordering office within \_\_\_ days that together call for quantities exceeding the limitation in subparagraph (1) or (2) above.

(c) If this is a requirements contract (i.e., includes the Requirements clause at subsection 52.216-21 of the Federal Acquisition Regulation (FAR)), the Government is not required to order a part of any one requirement from the Contractor if that requirement exceeds the maximum-order limitations in paragraph (b) above.

(d) Notwithstanding paragraphs (b) and (c) above, the Contractor shall honor any order exceeding the maximum order limitations in paragraph (b), unless that order (or orders) is returned to the ordering office within \_\_\_ days after issuance, with written notice stating the Contractor's intent not to ship the item (or items) called for and the reasons. Upon receiving this notice, the Government may acquire the supplies or services from another source.<sup>107</sup>

Definite quantity contracts require the Definite Quantity clause:

(a) This a definite-quantity, indefinite delivery contract for the supplies or services specified, and effective for the period stated in the Schedule.

(b) The Government shall order the quantity of supplies or services specified in the Schedule, and the Contractor shall furnish them when ordered. Delivery or performance shall be at locations designated in orders issued in accordance with the Ordering clause and the Schedule.

(c) Except for any limitations on quantities in the Delivery-Order Limitations clause or in the Schedule, there is no limit on the number of orders that may be issued. The Government may issue orders requiring delivery to multiple destinations or performance at multiple locations.

(d) Any order issued during the effective period of this contract and not completed within that time shall be completed by the contractor within the time specified in the order. The contract shall govern the Contractor's and Government's rights and obligations with respect to that order to the same extent as if the order were completed during the contract's effective period; provided, that the Contractor shall not be required to make any deliveries under this contract after [insert date].<sup>108</sup>

Requirements contracts must include the Requirements clause:

(a) This is a requirements contract for the supplies or services specified, and effective for the period stated, in the Schedule. The quantities of supplies or services specified in the Schedule are estimates only and are not purchased by this contract. Except as this contract may otherwise provide, if the Government's requirements do not result in orders in the quantities described as 'estimated' or 'maximum' in the Schedule, that fact shall not constitute the basis for any equitable price adjustment.

(b) Delivery or performance shall be made only as authorized by orders issued in accordance with the Ordering clause. Subject to any limitations in the Delivery-Order Limitations clause or elsewhere in this contract, the Contractor shall furnish to the Government all supplies or services specified in the Schedule and called for by orders issued in accordance with the Ordering clause. The Government may issue orders requiring delivery to multiple destinations or performance at multiple locations.

(c) Except as this contract otherwise provides, the Government shall order from the Contractor all the supplies or services specified in the Schedule that are required to be purchased by the Government activity or activities specified in the Schedule.

(d) The Government is not required to purchase from the Contractor requirements in excess of any limit on total orders under this contract.

(e) If the Government urgently requires delivery of any quantity of an item before the earliest date that delivery may be specified under this contract, and if the Contractor will not accept an order providing for the accelerated delivery, the Government may acquire the urgently required goods or services from another source.

(f) Any order issued during the effective period of this contract and not completed within that period shall be completed by the Contractor within the time specified in the order. The contract shall govern the Contractor's and Government's rights and obligations with respect to that order to the same extent as if the order were completed during the contract's effective period; provided, that the Contractor shall not be required to make any deliveries under this contract after [insert date].<sup>109</sup>

But Alternate I is required to be substituted for nonpersonal services contracts:

(c) The estimated quantities are not the total requirements of the Government activity specified in the Schedule, but are estimates of requirements in excess of the quantities that the activity may itself furnish within its own capabilities. Except as this contract otherwise provides, the Government shall order from the Contractor all of that activity's requirements for supplies and services specified in the Schedule that exceed the quantities that the activity may itself furnish within its own capabilities.<sup>110</sup>

Or Alternate II, when requirements include subsistence for both government use and resale, and similar products may be acquired on a brand-name basis:

(g) The requirements referred to in this contract are for items to be manufactured according to Government specifications. Notwithstanding anything to the contrary stated in the contract, the Government may acquire similar products by brand name from other sources for resale.<sup>111</sup>

Or Alternate III, if a partial small business or labor surplus set-aside is involved:

(c) The Government's requirements for each item or subitem of supplies or services described in the Schedule are being purchased through one non-set-aside contract and one set-aside contract. Therefore, the Government shall order from each Contractor approximately one-half of the total supplies or services specified in the Schedule that are required to be purchased by the specified Government activity or activities. The Government may choose between the set-aside Contractor and the non-set-aside Contractor in placing any particular order. However, the Government shall allocate successive orders, in accordance with its delivery requirements, to maintain as close a ratio as is reasonably practicable between the total quantities ordered from the two Contractors.<sup>112</sup>

Or Alternate IV, if both subsistence for government use and resale and a partial small business or labor surplus area set-aside is involved:

(c) The Government's requirements for each item or subitem of supplies or services described in the Schedule are being purchased through one non-set-aside contract and one set-aside contract. Therefore, the Government shall order from each Contractor approximately one-half of the total supplies or services specified in the Schedule that are required to be purchased by the specified Government activity or activities. The Government may choose between the set-aside Contractor and the non-set-aside Contractor in placing any particular order. However, the Government shall allocate

successive orders, in accordance with its delivery requirements, to maintain as close a ratio as is reasonably practicable between the total quantities order from the two Contractors.

[and]

(g) The requirements referred to in this contract are for items to be manufactured according to the Government specifications. Notwithstanding anything to the contrary stated in the contract, the Government may acquire similar products by brand name from other sources for resale.<sup>113</sup>

Indefinite-quantity contracts must include the Indefinite Quantity clause:

(a) This is an indefinite-quantity contract for the supplies or services specified, and effective for the period stated, in the Schedule. The quantities of supplies and services specified in the Schedule are estimates only and are not purchased by this contract.

(b) Delivery or performance shall be made only as authorized by orders issued in accordance with the Ordering clause. The Contractor shall furnish to the Government, when and if ordered, the supplies or services specified in the Schedule up to and including the quantity designated in the Schedule as the 'maximum.' The Government shall order at least the quantity of supplies or services designated in the Schedule as the 'minimum.'

(c) Except for any limitations on quantities in the Delivery-Order Limitations clause or in the Schedule, there is no limit on the number of orders that may be issued. The Government may issue orders requiring delivery to multiple destinations or performance at multiple locations.

(d) Any order issued during the effective period of this contract and not completed within that period shall be completed by the Contractor within the time specified in the order. The contract shall govern the Contractor's and the Government's rights and obligations with respect to that order to the same extent as if the order were



completed during the contract's effective period; provided, that the Contractor shall not be required to make any deliveries under this contract after [insert date].<sup>114</sup>

## 2. Letter Contracts

Sometimes the government's needs are so urgent that acquisition must proceed under an incomplete, undefinitized letter contract until a complete, definitized contract can be agreed between the parties. Letter contracts should be distinguished from "letters of intent" -- informal statements of intent to procure goods or services -- which are not authorized under the FAR. Such statements might induce prospective contractors to expend resources in anticipation of an contract, and they might seek to recover these expenses from the government or from the unauthorized issuer of such a statement.<sup>115</sup> "Letters of availability" were authorized, at least by the Veterans Administration, for "obtaining a place on the supplier's production or delivery schedule for long lead time items," subject to caveats similar to those associated with "letters of intent."<sup>116</sup>

The FAR governs letter contracts in 16.603. Letter contracts, authorizing immediate contractor performance, are used when it is in the government's interest that work begin immediately, before a definitive contract can be negotiated. The fiscal control laws are implemented by requiring that

price ceilings be stated when award is based on price competition. In other cases, the FAR generally requires definitization within 180 days or before 40 percent of the work has been performed, whichever is earlier, and the Limitation of Government Liability clause will be used to state the ultimate amount needed to cover the contractor's funding requirements until definitization. The amount stated may not exceed 50 percent of the estimated cost of the definitive contract unless approved by the agency head or designee who executed the determination and finding that no other contract form will be suitable. Letter contracts are specifically limited to the funds available at the time of execution<sup>117</sup> and to situations in which competition is impracticable, and they may not be amended to fulfill a new requirement unless inseparable from the subject matter of the letter contract.

In addition to the clauses required for the expected definitive contract, several clauses must be used in letter contracts. The first is the Execution and Commencement of Work clause:

The Contractor shall indicate acceptance of this letter contract by signing three copies of the contract and returning them to the Contracting Officer not later than \_\_\_\_\_ [insert date]. Upon acceptance by both parties, the Contractor shall proceed with performance of the work, including purchase of necessary materials.<sup>118</sup>

The second is the Limitation of Government Liability

clause:

(a) In performing this contract, the Contractor is not authorized to make expenditures or incur obligations exceeding \_\_\_\_\_ dollars.

(b) The maximum amount for which the Government shall be liable if this contract is terminated is \_\_\_\_\_ dollars.<sup>119</sup>

The third is the Contract Definitization clause:

(a) A \_\_\_\_\_ [insert specific type of contract] definitive contract is contemplated. The Contractor agrees to begin promptly negotiating with the Contracting Office the terms of a definitive contract that will include (1) all clauses required by the Federal Acquisition Regulation (FAR) on the date of execution of the letter contract, (2) all clauses required by law on the date of execution of the definitive contract, and (3) any other mutually agreeable clauses, terms, and conditions. The Contractor agrees to submit a \_\_\_\_\_ [insert specific type of proposal (e.g., fixed-price or cost-and-fee)] proposal and cost or pricing data supporting its proposal.

(b) The schedule for definitizing this contract is [insert target date for definitization of the contract and dates for submission of proposal, beginning of negotiations, and, if appropriate, submission of make-or-buy and subcontracting plans and cost or pricing data].

(c) If agreement on a definitive contract to supersede this letter contract is not reached by the target date in paragraph (b) above, or within any extension of it granted by the Contracting Officer, the Contracting Officer may, with approval of the head of the contracting activity, determine a reasonable price or fee in accordance with Subpart 15.8 and Part 31 of the FAR, subject to Contractor appeal as provided in the Disputes clause. In any event, the Contractor shall proceed with completion of the contract, subject only to the Limitation of

Government Liability clause.

(1) After the Contracting Officer's determination of price or fee, the contract shall be governed by --

(i) All clauses required by the FAR on the date of execution of this letter contract for either fixed-price or cost-reimbursement contracts, as determined by the Contracting Officer under this paragraph (c);

(ii) All clauses required by law as of the date of the Contracting Officer's determination; and

(iii) Any other clauses, terms, and conditions mutually agreed upon.

(2) To the extent consistent with subparagraph (c)(1) above, all clauses, terms, and conditions included in this letter contract shall continue in effect, except those that by their nature apply only to a letter contract.<sup>120</sup>

Alternate I is required for letter contracts awarded on the basis of price competition:

(d) The definitive contract resulting from this letter contract will include a negotiated [insert 'price ceiling' or 'firm fixed price'] in no event to exceed \_\_\_\_\_ [insert the proposed price upon which the award was based].<sup>121</sup>

Finally, the Payments of Allowable Costs Costs Before Definitization clause may be used when a cost reimbursement contract is contemplated, unless the acquisition involves conversion, alteration, or repair of ships:

(a) Reimbursement rate. Pending the placing of the definitive contract referred to in this letter contract, the Government shall promptly

reimburse the Contractor for all allowable costs under this contract at the following rates:

(1) One hundred percent of approved costs representing progress payments to subcontractors under fixed-price subcontracts; provided, that the Government's payments to the Contractor shall not exceed 80 percent of the allowable costs of those subcontractors.

(2) One hundred percent of approved costs representing cost-reimbursement subcontracts; provided, that the Government's payments to the Contractor shall not exceed 85 percent of the allowable costs of those subcontractors.

(3) Eighty-five percent of all other approved costs.

(b) Limitation of reimbursement. To determine the amounts payable to the Contractor under this letter contract, the Contracting Officer shall determine allowable costs in accordance with the applicable cost principles in Part 31 of the Federal Acquisition Regulation (FAR). The total reimbursement made under this paragraph shall not exceed 85 percent of the maximum amount of the Government's liability, as stated in this contract.

(c) Invoicing. Payments shall be made promptly to the Contractor when requested as work progresses, but (except for small business concerns) not more often than every 2 weeks, in amounts approved by the Contracting Officer. The Contractor may submit to an authorized representative of the Contracting Officer, in such form and reasonable detail as the representative may require, an invoice or voucher supported by a statement of the claimed allowable cost incurred by the Contractor in the performance of this contract.

(d) Allowable costs. For the purpose of determining allowable costs, the term 'costs' includes --

(1) Those recorded costs that result, at the time of the request for reimbursement, from payment by cash, check, or other form of actual payment for items or services purchased directly for the contract;

(2) When the Contractor is not delinquent in payment of costs of contract performance in the ordinary course of business, costs incurred, but not necessarily paid, for --

(i) Materials issued from the Contractor's stores inventory and placed in the production process for use on the contract;

(ii) Direct labor;

(iii) Direct travel;

(iv) Other direct in-house costs; and

(v) Properly allocable and allowable indirect costs as shown on the records maintained by the Contractor for purposes of obtaining reimbursement under Government contracts; and

(3) The amount of progress payments that have been paid to the Contractor's subcontractors under similar cost standards.

(e) Small business concerns. A small business concern may receive more frequent payments than every 2 weeks and may invoice and be paid for recorded costs for items or services purchased directly for the contract, even though it has not yet paid for such items or services.

(f) Audit. At any time before final payment, the Contracting Officer may have the Contractor's invoices or vouchers and statements of costs audited. Any payment may be (1) reduced by any amounts found by the Contracting Officer not to constitute allowable costs or (2) adjusted for overpayments or underpayments made on preceding invoices or vouchers.<sup>122</sup>

### 3. Basic Agreements and Basic Ordering Agreements

Two other contractual devices, although not contracts in themselves, used to accommodate limited fiscal year resources to the needs of agencies to maintain reasonably

certain levels of activity, are the Basic Agreement and the Basic Ordering Agreement.

The Basic Agreement (BA) is defined as

a written instrument of understanding negotiated between an agency or contracting activity and a contractor, that (1) contains contract clauses applying to future contracts between the parties during its term and (2) contemplates separate future contracts that will incorporate by reference or attachment the required and applicable clauses agreed upon in the basic agreement.<sup>123</sup>

Basic Agreements generally may be used with either fixed price or cost reimbursement type contracts, although DOD restricts their use to negotiated contracts.<sup>124</sup> Later formal contracts incorporating the Basic Agreement will specify the price, quantity, delivery and other remaining terms. Either party may disavow a negotiated basic agreement with 30 days' written notice. Basic Agreements may neither cite nor obligate funds.

The Basic Ordering Agreement (BOA) is similar, except that it describes the supplies or services, and contains a price determination method. The Basic Ordering Agreement is defined as

a written instrument of understanding negotiated between an agency contracting activity, or contracting officer and a contractor, that contains (1) terms and clauses applying to future contracts (orders) between the parties during its term, (2) a description, as specific as practicable, of supplies

or services to be provided, and (3) methods for pricing, issuing, and delivering future orders under the basic ordering agreement.<sup>125</sup>

Orders placed under a basic ordering agreement may become binding contracts when each order is issued, when each order is accepted, or when each order has not been rejected within some stated time, as specified in the basic ordering agreement. They are used when the exact items, quantities and prices are not known at the time of the agreement.

While neither device is to be used to commit the government to purchase from party contractors, but rather to reduce negotiation problems and administrative lead times,<sup>126</sup> a basic ordering agreements may contemplate not ordering from any other source if it has first been determined that competition is impracticable, and the prospective basic ordering agreement has been synopsized.<sup>127</sup> Before ordering under such a basic ordering agreement, contracting officers must determine that competition is impracticable, and generally proceed as if the order were a contract issued independently of the basic ordering agreement. The fiscal control laws are implemented by prohibiting contracting before prices are fixed or without stating a ceiling price limiting the government's obligation along with procedures to price performance unless the "need for the supplies or services is compelling and unusually urgent (i.e., when the Government would be seriously injured, financially or otherwise, if the



requirement is not met sooner than would be possible if prices were established before the work began).

A similar device is the GSA Office of Federal Supply and Service (FSS) Multiyear Multiple Award Schedule (MAS) program, under which FSS could contract with numerous suppliers of similar goods, promising that if serviced government agencies develop requirements for such goods during the multiyear term of the agreement, the agencies generally will purchase directly from suppliers offering the lowest price, using a purchase order. Since no binding commitment to spend any government funds arises until the using agencies exercise their administrative judgment during a given fiscal year to place an order under the agreement, the program does not violate either 31 U.S.C. § 1341 (a)(1)(B), 41 U.S.C. § 11, or 31 U.S.C. § 1502, even though the serviced agencies ordinarily use annual funds to place their orders. Serviced agencies' agents must themselves insure that adequate funds are actually available and that there exists a bona fide need for the period in which the obligations are created, if annual funds are used.<sup>128</sup>

Federal Supply Schedule (FSS) purchase orders cannot be cancelled by issuing agencies with impunity should funds later become exhausted. The Comptroller has decided that the government's liability is not extinguished by subsequent funds

unavailability, in such cases.<sup>129</sup>

## D. Multiyear Contracts

### 1. Generally

FAR multiyear contracts<sup>130</sup> conditionally bind the government to buy stated quantities of more than one year's but fewer than five years' requirements. Longer terms are permissible only with specific statutory authorization. Funds need only be available for the first year's performance at time of award. Generally, level unit prices are required throughout the multiyear period, requiring the contractor not to recover all nonrecurring startup costs in the first year, but rather to spread them over the whole contract term. Multiyear cancellation provisions insulate the contractor at least from loss of these nonrecurring initial costs, which would otherwise be unrecouped should the contract be cancelled prematurely. The FAR permits variable unit prices as an exception that may be approved by the head of a contracting activity when level unit prices are not in the government's interest, provided there is some valid method of evaluating competitive proposals, and also permits modifying or excluding cancellation provisions.<sup>131</sup>

The clauses used with multiyear contracts condition the contractor's obligation to proceed with each year's performance upon timely receipt of written notice of availability of funds. If funds are not made available for subsequent years, or if notice of funds availability is not timely received, the contractor is not bound by the multiyear contract and the contract is considered cancelled.<sup>132</sup> The government's payment obligation is always limited to the amount available for contract performance, and the amount specified in the contract is required to be modified in successive years to reflect actual availability.<sup>133</sup>

Timely oral notice of funds availability combined with later written confirmation has been held sufficient since it served the main purposes of the notice requirement of the Limitation of Price and Contractor Obligation clause to relieve the contractor of any obligation to incur costs for later years until funds are certainly available and to give the government control over the timing of future obligations of appropriated funds, "a provision necessary in light of the practices by which Congress exercises budgetary control."<sup>134</sup> The Armed Services Board has written that the principal reason for requiring a writing "was to insure compliance with the statutory prohibition on the over-obligation of appropriated funds and the requirement for the orderly recording of the Government's fiscal obligations."<sup>135</sup>

Multiyear contracts are appropriate when reduced total costs are expected, minimum needs are forecast to remain unchanged throughout the multiyear period, stable funding is expected to be available, the item design is stable with low technical risks, and annual contracting cost and multiyear contracting cost savings estimates are believed realistic.<sup>136</sup> The FAR encourages the use of multiyear contracting to achieve these objectives:

- (1) Lower costs.
- (2) Enhancement of standardization.
- (3) Reduction of administrative burden in the placement and administration of contracts.
- (4) Substantial continuity of production or performance, thus avoiding annual startup costs, pre-production testing costs, make-ready expenses, and phaseout costs.
- (5) Stabilization of contractor work forces.
- (6) Avoidance of the need for establishing and 'proving out' quality control techniques and procedures for a new contractor each year.
- (7) Broadening the competitive base with opportunity for participation by firms not otherwise willing or able to compete for lesser quantities, particularly in cases involving high startup costs.
- (8) Provide incentives to contractors to improve productivity through investment in capital facilities, equipment, and advanced technology.<sup>137</sup>

Multiyear contracts have been compared to indefinite or optional quantities contracts, because the government is

obligated in each case to purchase a substantial minimum quantity while the contractor is obligated to sell more, if ordered within the specified time period. Still, under a multiyear contract the government is obligated to purchase, subject to the availability of funds, without any election to buy or not to buy any particular year's requirements based on then-market market conditions, other than the authority provided by the Termination for Convenience clause.<sup>138</sup>

This difference is reinforced by a consideration of the legislative history of Public Law 90-378. This statute granted the Department of Defense statutory authority to enter into certain multiyear contracts outside the United States. The Senate Report shows that the principal purpose of the authorization was to avoid the increased costs resulting from the uncertainty of the Government's obligation incident to the use of single year contracts with options to renew. Sen. Report 1313, 90th Cong., 2d Sess. (1968).<sup>139</sup>

Agency refusal to fund a multiyear contract, when such funds are available, has been construed as a termination for convenience of the government.<sup>140</sup> However, even though the clause does not specifically so provide, the ASBCA has upheld cancellation when the agency did not request funds when there was no longer any requirement for the goods.<sup>141</sup>

## 2. Cancellation Ceilings

Contractors are usually protected against loss of at least nonrecurring initial costs with a multiyear contract

through its termination provisions. Nonrecurring costs include preproduction engineering, plant relocation and rearrangement, special tooling and equipment, specialized workforce training, and initial spoilage or rework and associated labor. Recurring costs are those which vary in some proportion to the quantity being produced (including out-year components, parts and work-in-progress and associated labor) -- under the DAR, recurring costs initially could not be included in the cancellation ceilings but Pub. L. No. 97-86, § 909, gave DOD authority to include recurring costs in cancellation ceilings. Including recurring costs is permitted as an exception to normal contract financing arrangements, requiring the prior approval of the agency head or designee.<sup>142</sup> But, if included, unamortized recurring costs must be funded, unlike unamortized nonrecurring costs, which continue to be treated as contingent liabilities.

Under the DAR, cancellation ceilings including only nonrecurring costs specifically were not required to be funded prior to cancellation, and the FAR continues this policy.<sup>143</sup> As noted in Chapter IV, however, multiyear contracts in DOD must generally be funded to the level required to end the contract's out-year requirements at the end of a fiscal year, including both funded, unamortized recurring costs and unfunded, unamortized nonrecurring costs.

Cancellation ceilings, which the FAR defines as the "maximum amount that the Government will pay the contractor which the contractor would have received as a part of the unit price, had the contract been completed," are limits on actual contractor recoveries of unrecovered costs, called cancellation charges.<sup>144</sup> Cancellation ceilings are established for each program year subject to cancellation -- all after the first year --and the ceilings are reduced each year in direct proportion to the remaining requirements subject to cancellation. For example, in a five-year multiyear contract if total included costs were estimated at 10 per cent of the total multiyear cost, with 30 per cent of the total contract requirements to be satisfied the first year, then the cancellation ceiling for the second year would be seven per cent of the total price (subtracting three per cent for the first year); 30 per cent to be satisfied in the second year, then the ceiling for the third year would be four per cent; 20 per cent in the third year, then the ceiling for the fourth year would be two per cent; and 10 per cent in the fourth year, the ceiling for the fifth year would be 1 per cent. There would be no cancellation ceiling applicable to termination during the last year, since the termination for convenience provisions of the contract would apply.<sup>145</sup>

Cancellation charges may be less inclusive than termination costs. Cancellation charges generally include

only nonrecurring costs and a reasonable profit on such costs, while termination for convenience settlements include reasonable, allocable costs incurred to the point of termination, whether recurring or nonrecurring, and a reasonable profit on such costs. Termination may occur at any time under the termination for convenience provisions, but cancellation may be effective only at a fiscal year's end for all subsequent fiscal years' quantities. However, in the multiyear contracting context, at least in DOD, "termination liability funding" refers to the maximum cost that the government would incur under the contract if the requirement for out-year quantities were ended at the end of a fiscal year. A multiyear contract terminated before the end of a fiscal year entitles the contractor to both a termination settlement and any remaining out-year cancellation charges, including both unfunded unamortized recurring costs and any included, funded unamortized recurring costs.

### 3. Evaluation of Offers

Cancellation ceilings over \$100 million may not be included in any DOD contract without prior notification to the Committees on Armed Services and on Appropriations of the Senate and House of Representatives, and award may not be made until 30 days after notification. In addition, DOD components must comply with any notification requirements or restrictions



contained in the annual authorization or appropriation acts.<sup>146</sup>

Offers on multiyear contracts are usually evaluated by determining the lowest overall cost for both the multiyear and the first program year acquisition and comparing the cost of buying the total requirement with a multiyear contract to the cost of satisfying the requirement through successive acquisitions when both single-year and multiyear offers are solicited. Single-year prices are not considered when competition after the first year would be impracticable and a "buy-in" with an unreasonably low first-year offer must be prevented.<sup>147</sup> The comparison is done by multiplying the unit price on the first year alternative by the number of units required over the multiyear period, adding any administrative costs to be considered, and comparing this figure to the lowest multiyear alternative offer.<sup>148</sup> But either economic price adjustment clauses or contingency factors included by contractors to compensate for the lack of such clauses may defeat the agencies' chief goal in using multiyear contracts: to achieve lower total costs by allowing contractors to spread costs recovery over more than the first year of performance.<sup>149</sup>

#### 4. Funding

The multiyear contract device, as developed by the DOD, is used to obtain known requirements of military supplies and services in quantities not in excess of planned requirements for five years. The agency promises to order the items in future years if funds are available, or to pay a cancellation charge. Absent some specific statutory authority, annual funds may not be used to fund multiyear contracts because neither promise can be related to the bona fide needs of the current year.<sup>150</sup> Multiyear funding could be used, in which Congress authorizes and appropriates funds covering more than one fiscal year. Multiple-year or no-year funds, covering only one fiscal year's requirements but permitting more than one year to obligate the funds, could also be used. Annual funds are subject to the bona fide needs rule, and may only be obligated by a valid, binding contract entered into during the current fiscal year.<sup>151</sup> On the other hand, the cost of cancellation or termination may be paid from appropriations originally available for that contract, appropriations currently available for procurement of that kind of goods or services, or funds specially appropriated to pay such charges.

Specific statutory authority to use annual funds for services contracts and items of supply related to such

services "for periods of not more than five years" has been provided DOD components in 10 U.S.C. § 2306 (g) for the operation, maintenance and support of facilities and installations; modification or maintenance of complex military equipment, such as aircraft, ships, vehicles; specialized training requiring "high quality" instructor skills; and base services, including ground maintenance, refueling, bus transportation, refuse collection and disposal. Under the authority of Pub. L. 91-142, Section 512, both supplies and services may be acquired for up to a four-year period using annual funds to maintain and operate family housing. In both these cases of specific statutory authorization to use annual funds for multiyear purposes, performance years are required by the FAR to coincide with fiscal years.<sup>152</sup>

DOD has been provided multiyear contracting authority for property in 10 U.S.C. § 2306 (h), "including weapon systems and items and services associated with weapon systems (or the logistics support thereof)," but this authority is limited to "the extent that funds are otherwise available for obligation." Section 2306 (h) may be considered as a statutory exception to the bona fide needs rule and the antideficiency laws. It authorizes multiyear contracting for supplies "to the extent funds are otherwise available." Such contracts are fully funded to the extent of the cost of each fiscal year's programmed requirements -- but the out-year

cancellation charges are not funded, except to the extent recurring costs (including parts, components, materials and associated labor) are included within the multiyear contract's cancellation liability, nor are they unquestionably associated with a bona fide need of the year in which the obligation was formed. But if such a contract were to be cancelled, Subsection 2306 (h)(5) specifically permits cancellation charges to be paid from the funds initially obligated, future years' appropriations, or appropriations made specifically for that purpose. By policy, DOD restricts the use of annual Operation and Maintenance funds to "consumable" items costing less than \$3000 per unit. Other supplies must be purchased with procurement funds.

As noted by Professors Nash and Cibinic, the Commission on Government Procurement recommended "that the use of multiyear procurement not be limited to no-year and multiple-year funds and that all executive agencies be given the authority by statute to enter into multiyear contracts with annual money when requirements are firm, start-up costs are high and competition would be facilitated."<sup>153</sup> This position has been supported by the Comptroller General.<sup>154</sup>

In the 98th Congress, S. 2300 expired with the Congress after passage by voice vote in the Senate on May 23, 1984 and referral in the House to the Committee on Government

Operations. It had not yet been reintroduced in the 99th Congress, as this thesis was being put in final form. S. 2300 would have amended the Federal Property and Administrative Services Act to give the civilian agencies statutory authority to enter into multiyear contracts for no more than five years. The bill specified criteria designed to restrict use to cases in which the agency expected stable funding, stable need and stable design; the best interests of the government, the encouragement of competition, or cost reduction would be served; and small business participation would not be inhibited. The bill was intended to achieve cost savings, better quality, more competition, and to curtail wasteful year end spending surges.

## 5. Alternatives

Absent statutory authority to use annual funds for the needs of other periods,<sup>155</sup> one available alternative contractual arrangement would be an unconditional contract for the first year's requirements with renewal options for succeeding years. In such a contract, the government may not agree to a termination penalty which would compensate the contractor for the unamortized balances on nonrecurring initial expenses, because such penalties represent "a part of the price of future, as opposed to current deliveries, and needs under the contract, and for that reason such charges are

not based on a current fiscal year need."<sup>156</sup> Option contracts may contain price adjustment provisions to reduce the price proportionately to the amount of such costs which will be recovered when the renewal option is exercised -- still, the government in effect is purchasing part of the contractor's plant and ordinarily cannot take a reciprocal title interest because, absent specific authority, the government is prohibited from acquiring public buildings and improvements.<sup>157</sup>

Other contractual alternatives to be considered would include conditional contracts and indefinite delivery contracts, as discussed above.

## **6. Multiyear Contract Clauses**

The FAR, in 17.105 (a)(1) & (2), prescribes use of two major clauses in multiyear contracting.

### **a. Limitation of Price and Contractor Obligations**

The first is the Limitation of Price and Contractor Obligations clause:

(a) Funds available for performance are described in the Schedule. The amount of funds available at award is not considered sufficient for the performance required for any program year other

than the first program year. When additional funds are available for the full requirements of the next succeeding program year, the Contracting Officer shall, not later than the date specified in the Schedule (unless a later date is agreed to), so notify the Contractor in writing. The Contracting Officer shall also modify the amount of funds described in the Schedule as available for contract performance. This procedure shall apply for each successive program year.

(b) The Government is not obligated to the Contractor for any amount over that described in the Schedule as available for contract performance.

(c) The Contractor is not obligated to incur costs for the performance required for any program year after the first unless and until written notification is received from the Contracting Officer of any increase in availability of funds. If so notified, the Contractor's obligation shall increase only to the extent contract performance is required for the additional program year for which funds are made available.

(d) If this contract is terminated under the 'Termination for Convenience of the Government' clause, 'total contract price' in that clause means the amount available for performance of this contract, as in paragraph (a) above, plus the amount established as the cancellation ceiling. 'Work under the contract' in that clause means the work under program year requirements for which funds have been made available. If the contract is terminated for default, the Government's rights under this contract shall apply to the entire multiyear requirements.

(e) Notification to the Contractor of an increase or decrease in the funds available for performance of this contract under another clause (e.g., an 'Option' or 'Changes' clause) shall not constitute the notification contemplated by paragraph (a) of this clause.<sup>158</sup>

#### **b. Cancellation of Items**

The second clause required for use in multiyear contracts is the Cancellation of Items clause:

(a) 'Cancellation,' as used in this clause, means that the Government is canceling its requirements for all items in program years subsequent to that in which notice of cancellation is provided. Cancellation shall occur, by the date or within the time period specified in the Schedule (unless a later date is agreed to), if the Contracting Officer (1) notifies the Contractor that funds are not available for contract performance for any subsequent year or (2) fails to notify the Contractor that funds are available for performance of the succeeding program year requirement.

(b) Except for cancellation under this clause or termination under the 'Default' clause, any reduction by the Contracting Officer in the requirements of this contract shall be considered a termination under the 'Termination for Convenience of the Government' clause.

(c) If cancellation under this clause occurs, the Contractor will be paid a cancellation charge not over the cancellation ceiling specified in the Schedule as applicable at the time of cancellation.

(d) The cancellation charge will cover only (1) costs (i) incurred by the prime contractor and/or subcontractor, (ii) reasonably necessary for the performance of the contract, and (iii) that would have been equitably amortized in the unit prices for the entire multiyear contract period but, because of the cancellation, are not so amortized, and (2) a reasonable profit on the costs.

(e) The cancellation charge shall be computed and the claim made for it as if the claim were being made under the 'Termination for Convenience of the Government' clause of this contract. The Contractor shall submit the claim promptly but no later than 1 year from the date (1) of notification of the nonavailability of funds, or (2) specified in the Schedule by which notification of the availability of additional funds for the next succeeding program year is required to be issued, whichever is earlier, unless extensions in writing



are granted by the Contracting Officer.

(f) The Contractor's claim may include --

(1) Reasonable nonrecurring costs (see FAR 15.8) which are applicable to and normally would have been amortized in all items to be furnished under the multiyear requirements;

(2) Allocable portions of the costs of facilities acquired or established for the conduct of the work, to the extent that it is impracticable for the Contractor to use the facilities in its commercial work and if the costs are not charged to the contract through overhead or otherwise depreciated;

(3) Costs incurred for the assembly, training and transportation to and from the job site of a specialized work force; and

(4) Costs not amortized by the unit price solely because the cancellation had precluded anticipated benefits of Contractor or subcontractor learning.

(g) The claim shall not include --

(1) Labor, material or other expenses incurred by the Contractor or subcontractors for performance of the canceled work;

(2) Any cost already paid to the Contractor;

(3) Anticipated profit on the canceled work; or

(4) For service contracts, the remaining useful commercial life of facilities. 'Useful commercial life' means the commercial utility of the facilities rather than their physical life with due consideration given to such factors as location of facilities, their specialized nature, and obsolescence.

(h) This contract may include an 'Option' clause with the period for exercising the option limited to the date in the contract for notification that funds are available for the next succeeding program year. If so, the Contractor agrees not to include in the price for option quantities any costs

of a startup or nonrecurring nature, that have been fully provided for in the unit prices of the firm quantities of the program years. The Contractor further agrees that the prices offered for option quantities will reflect only those recurring costs, and a reasonable profit necessary to furnish the additional option quantities.

(i) Quantities added to the original contract through the 'Option' clause of this contract shall be included in the quantity canceled for the purpose of computing allowable cancellation charges.<sup>159</sup>

**c. Alternate for Multiyear Modified Requirements  
Contracts**

Alternate I is prescribed for "multiyear modified requirements" contracts awarded for more than one program year, as a substitute for paragraph (a), with the deletion of paragraph (b) above:

(a) As used herein, the term 'cancellation' means that the Government is cancelling pursuant to this clause, its anticipated requirements for items as set forth in the schedule for all program years subsequent to that in which notice of cancellation is provided. Such cancellation shall occur if, by the date or within the time period specified in the schedule or such further time as may be agreed to, the Contracting Officer (1) notifies the Contractor that funds will not be available for contract performance for any subsequent program year or (2) fails to notify the Contractor that funds will be available for performance of a requirement for the succeeding program year. 'Cancellation' shall also be deemed to have occurred if, upon expiration of the final program year, the Government has failed to order the specified items in quantities up to the aggregate Best Estimated Quantity set forth in the Schedule. Following cancellation under this clause of any program year(s), the Government shall not be obligated to issue nor the Contractor to accept any

further orders under this contract.<sup>160</sup>

Multiyear modified requirements contracts are authorized when anticipated annual requirements (BEQ's) can be estimated with "reasonable certainty." A fixed-price contract is awarded for quantities up to a stated maximum and orders for additional quantities are placed during the multiyear period. This form of contract differs from a FAR 16.503 requirements contract in that the BEQ's state the quantities expected to be acquired, nonrecurring costs are expected to be amortized over the BEQ's, the contractor is entitled to recover preproduction and other nonrecurring costs subject to the contract schedule cancellation ceiling should the agency order less than the aggregate stated BEQ's or cancels prematurely, and quantities over the aggregate BEQ's up to the total multiyear contract maximum quantity will be priced net of nonrecurring costs because they will already have been recovered by that time.<sup>161</sup> No cancellation charges will be allowed, if the contract is awarded based on an alternative first year program bid.<sup>162</sup>

#### **E. Multiyear Procurement Related to Advance Acquisition**

Despite the fact that the FAR requires funds to be budgeted, financed, appropriated and obligated only for the first year's requirement under a multiyear contract at the time of award, with succeeding years' requirements to be

funded annually in the year for which authorized, the full funding policy still requires full funding of procurements within the Procurement title of the annual appropriations act.<sup>163</sup> In DOD, multiyear contract quantities are budgeted and financed in accordance with the DOD Five-Year Defense Program, and are integrated into the Planning, Programming and Budgeting System (PPBS), through the services' Program Objective Memorandum (POM) and Budget Estimate Submissions (BES).<sup>164</sup> Recognized exceptions to the full funding policy are advanced long lead and economic order quantity (EOQ) acquisition, both classed as "advance acquisition."<sup>165</sup> Advance acquisitions necessarily comprehend materials, parts and components as well as costs associated with their processing.<sup>166</sup> Advance acquisitions are not considered multiyear acquisitions in the FAR sense.<sup>167</sup>

Advance procurement is an exception to the rule that a procurement contract should call for the delivery of complete items. In effect, the funds obligated when an annual advance procurement contract is awarded represent a partial advance against the total funding required to purchase the complete end items called for in the main annual contract -- a contract yet to be awarded and, in most instances, not yet funded. For this reason, even if the relevant appropriation is fully adequate to cover the payments due under the advance procurement contract, the advance procurement is regarded as an exception to the full funding rule as well as to the rule that a procurement contract should call for complete end items.

. . . .

. . . Nonetheless, advance procurement has been taking up a growing share of the procurement appropriations.

One reason for this growth has been an increase in the number and variety of long lead time items truly needed for timely production. Another reason (perhaps influencing decisions at the margin) may have been the perception that components and other inputs for which the price is especially sensitive to production rate or order quantity could be obtained more cheaply if broken out from the main annual contract and purchased in increased quantity under an advance procurement contract. According to this view, advance procurement can both reinforce multiyear procurement and to some extent substitute for it.<sup>168</sup>

In view of the limitations placed on the use of multiyear contracting in practice, despite DOD's now-enlarged statutory authority, consideration has been given to the degree to which advance procurement could be used to achieve some of the same objectives as multiyear procurement. For example,

It appears, therefore, that advance procurement contracts can be used widely in the future, in both the annual and multiyear form. Advance procurement contracts in the multiyear form may also be used either to support multiyear, complete-end-item contracts or partly to substitute for them as a means of achieving production efficiencies and cost savings. In other words, the procurement of complete end items could continue to be handled in the normal way, by means of annually funded annual contracts, while multiyear advance procurement contracts could be used to exploit opportunities for production efficiency and cost savings in purchasing selected inputs to the production of the complete end item. Thus it may be possible to achieve substantial savings through a multiyear advance procurement while continuing to enjoy the advantages of annual contracting for the bulk of a procurement program.

There is, however, almost always some risk that the programmed number of complete end items will not be manufactured, and therefore that the inputs contracted for in advance procurement will turn out to be excess to manufacturing needs. The consequences are generally not serious when the advance procurement contract is limited to a single year's requirement of inputs that are end items themselves, or can be used as spare parts, or, like some raw materials, can find a ready civilian market. But the risk of overbuying presumably increases as the advance procurement contract is expanded to provide for additional years of requirements. And the consequences of overbuying presumably become more serious as the contract is extended to include 'bits and pieces' for which, apart from their role as inputs to end-item production, there is neither military use nor civilian market. The achievement of net savings through expanded use of advance procurement will require a careful weighing of these risks and their consequences. <sup>169</sup>

These risks inherent in advance acquisition might be limited through the use of incrementally funded annual contracts for such components, materials and parts with priced options for future years' performance.

## Chapter V: Footnotes

1. 39 Comp. Gen. 340 (1959); 21 Comp. Gen. 864 (1942).
2. 39 Comp. Gen. 776 (1960); see Air Force FAR Sup. 32.790(j).
3. Restatement (Second), Contracts §§ 78, 250 (Tent. Draft, 1973).
4. Cf. U. S. Envelope Co., PSBCA 169, 76-2 BCA ¶ 12,056 (1976); 49 Comp. Gen. 431 (1970).
5. Comp. Gen. Dec. B-171798(1), August 18, 1971, unpub.; 39 Comp. Gen. 776 (1960); 39 Comp. Gen. 340 (1959); 21 Comp. Gen. 864 (1942).
6. 271 U.S. 204 (1926).
7. Goodyear v. United States, 276 U.S. 287 (1928); 28 Comp. Gen. 553 (1949).
8. R. Nash and J. Cibinic, I Federal Procurement Law 691 n.5 (1977).

9. Thomson v. United States, 174 Ct. Cl. 780, 357 F.2d 683 (1966); Schiffart-und Kohlen-agentur, ASBCA 10219, 65-2 BCA ¶ 5038 (1965).
10. H. R. Morgan Contracting Co., ASBCA 12845, 68-1 BCA ¶ 6943 (1968).
11. R. Nash and J. Cibinic, I Federal Procurement Law 117-118 n.3 (1977).
12. 31 Comp. Gen. 477 (1952).
13. See generally, R. Nash and J. Cibinic, I Federal Procurement Law 688-689 nn.1-3 (1977).
14. 208 Ct. Cl. 716, 530 F.2d 878 (1976).
15. 28 Comp. Gen. 163 (1948).
16. 56 Comp. Gen. 437 (1977), overruling 2 Comp. Gen. 477 (1923).
17. 177 Ct. Cl. 800, 369 F.2d 743 (1966).
18. 18 Ct. Cl. 138, 146-147 (1883).



19. River and Harbor Act of September 22, 1922, ch. 427, § 10, 42 Stat. 1043, 33 U.S.C. § 621; see Hearings on H. R. 10766, House Committee on Rivers and Harbors, 67th Cong., 2d Sess., at 93-94.
20. SP-19, Appendix A to Leavell, 530 F.2d at 894.
21. 2 Comp. Gen. 477, 479 (1923).
22. 530 F.2d at 888.
23. *Id.* at 890.
24. *Id.* at 893.
25. See, e.g., *Ferris v. United States*, 27 Ct. Cl. 542 (1892).
26. 530 F.2d at 890.
27. 56 Comp. Gen. 437, 438 (1977).
28. 530 F.2d at 886.
29. 56 Comp. Gen. at 441.

30. 56 Comp. Gen. at 442, citing as authority *Shipman v. United States*, 18 Ct. Cl. 138, 146-147 (1883).

31. 56 Comp. Gen. at 442.

32. See 33 U.S.C. § 579 (providing for deauthorization of projects not funds for eight years).

33. See 33 C.F.R § 263. The "continuing authorities" program is based on seven statutes covering (1) small flood control project authority, 33 U.S.C. § 701s; (2) snagging and clearing for flood control, 33 U.S.C. § 701g; (3) emergency streambank and shoreline protection of public works and nonprofit public services, 33 U.S.C. § 701r; (4) small navigation projects, 33 U.S.C. § 577; (5) snagging and clearing for navigation, 33 U.S.C. § 603a; (6) small beach erosion control project authority, 33 U.S.C. § 426g; and (7) mitigation of shore damages attributable to navigation projects, 33 U.S.C. § 426i.

34. See, e.g., 10 U.S.C. § 2828 (g)(1); 43 U.S.C. § 388.

35. *Granite Const. Co.*, IBCA 947-1-72, 72-2 BCA ¶ 9762 (1972).

36. 76-1 BCA ¶ 11,793 (1976).

37. See, e.g., Ball Brothers Research Corp., NASA 1277-6, 80-2 BCA ¶ 14,525 (1980).
38. IBCA 944-12-71, 74-2 BCA ¶ 10,708 (1974).
39. 576 F.2d 299 (1978).
40. Winston Bros. Co. v. United States, 131 Ct. Cl. 245 (1955).
41. 576 F.2d at 305.
42. Id. at 306.
43. Id. at 307.
44. Id.
45. Gunther and Shirley Co. and E. V. Lane Corp., EngBCA 3691, 78-2 BCA ¶ 13,454 at 65,756-65,757 (1978)
46. Id. at 65,757.
47. 321 U.S. 730, 734 (1944)(in which the Court wrote that the government had no duty to aid a contractor to finish prior to the agreed completion date).

48. 78-2 BCA at 65,758.
49. 1 Cl. Ct \_\_\_\_, 30 CCF ¶ 70,909 (1983).
50. 30 CCF at 75,946.
51. Id. at 75,947.
52. 681 F.2d 756 (1982).
53. 30 CCF ¶ 70,909 at 75,948.
54. Id. at 75,948 n.2.
55. R. Nash and J. Cibinic, I Federal Procurement Law 689 n.3 (1977).
56. Id. at 689 (emphasis added).
57. See FAR 32.700.
58. See Memorandum from J. H. Summers, FAR Project Manager, to Mr. William J. Maraist, Assistant Administrator for Regulations, OFPP, August 30, 1982 at 101-28. Attached to this memorandum, the spreadsheets recording the comments of

interested parties on the Phase I FAR Part 32, Subpart 32.7, and the reactions of the FAR Project Office.

59. Memorandum from Boyd W. Allen Jr., Office of the Secretary of the Air Force General Counsel to AF/RDC, "AFSC Query Regarding DAR (ASPR) 7-402.2 (c) Limitation of Funds Clause and FMS Direct Cite Financial Management Procedures," April 9, 1979 at 3.

60. FAR 52.232-18.

61. FAR 32.703-2.

62. See 28 Comp. Gen. 163 (1948).

63. Air Force FAR Sup. 32.790(j).

64. FAR 37-703-2 (b).

65. FAR 52.232-19; see FAR 37.106.

66. FAR 37.703 (c).

67. See 21 Comp. Gen. 864 (1942).

68. FAR 32.703-3.

69. Memorandum, note 58 supra, spreadsheets attachment at 101-14.

70. Id.

71. See FAR 45.301 for definitions of these terms.

72. Love, The Significance of Funding Limitations in Government Contracts, 6 The Colo. Law. 429, 431 (1977); see also Feuerborn, The Limitation of Cost Clause, 10 Yearbook Proc. Art. 885 (1973). Two commentators have suggested other ends perhaps inadvertently achieved by the LOC clauses: transferring the risk of overruns in cost reimbursement type contracts from the government to its contractors when inadequate funds are obligated, permitting a basis for sub silentio inducements to contractors to continue performance unfunded until funds are made available and the clause then operates to entitle contractors to payment for their voluntarily-risked unfunded efforts. Jackson & Nielsen, In Search of Fairness: The "Limitation of Cost" Odyssey, 12 Yearbook Proc. Art. 41-42 (1975). The LOC clauses can impose substantial costs on both the government and its contractors:

The administration of the clauses is costly for both Government and industry; stopping and restarting work due to delays in making added funds available on a timely basis would be even more expensive for the Government but for voluntary, risky continuations of performance by contractors, who, even when subsequently funded, cannot recover the cost of capital imputable to receivables carried in unbilled accounts for abnormally long periods of time; and the losses incurred because of adverse administrative, contract appeals and court decisions are extensive in amount and impact. Such economic costs were recognized as a major problem by the Commission on Government Procurement.

Id. at 42 (citing Report of the Commission on Government Procurement, Vol. I, Chapter 7 (1972)).

Despite the clauses, costs after surpassing the stated limit sometimes may be recoverable on the basis of an implied-in-fact contract:

The cases show that the bare language of the LOC clause is never, without considering other factors, found sufficient to dispose of the issues. Clearly, this is a result of the complexity of the surrounding circumstances, and not testimony to bad draftsmanship. Extrinsic evidence, in LOC, as in other Government contract cases, is always necessary to the process of determining what legal consequences will be made to flow from the clause itself and the rest of the contract. As a question of law, interpretations given the LOC clause by Appeal Boards are not accorded finality and are not subject to the standards limiting judicial review as prescribed by the Wunderlich Act. The Appeal Boards and Court of Claims have been consistent in finding the conduct of the parties of prime importance as a manifestation of intent as the meaning the parties have attached to the clause; or as a showing that an implied-in-fact contract (to continue work) had been made. The reasonableness of alternative interpretations of the LOC clause has been tested by the Boards and Court by avoiding interpretations

which cause a conflict with other provisions, taking all circumstances into account, and interpreting the contract as a whole.

Id. at 46 (citing Hittman Assoc., Inc., ASBCA 14638, 71-1 BCA 8706 (1971); American Standard, Inc., ASBCA 15660, 71-2 BCA 9109 (1971)).

Further, the LOC clause cost limit can be waived by the government:

Many early cases have shown that knowledge by the Government of an overrun or near overrun, coupled with Government requests to continue, may constitute a waiver of the cost limitation stated in the LOC clause. This constructive 'waiver' is prompted by an instinct for fairness under the circumstances and it represents a recognition that knowledge of an overrun followed by the Government's urging that work be continued constitutes a supplemental, implied-in-fact contract. Most of the cases apparently fail to show by the evidence that there was a 'tacit' understanding that the cost limit would be increased; nevertheless, the Boards and Courts alike will find consent if the Government has knowledge and, after acquiring this knowledge, has continued to request performance.

Id. at 51. Accord, OAO Corporation, DOT CAB 1280, 83-1 BCA ¶ 16,298 (contractor's failure to give notice does not deprive contracting officer of discretion to fund overrun).

But recovery will generally not be available on a quantum meruit basis:



[T]here is implicit in the holdings a . . . practical reason to bar recovery. That is, if quantum meruit was allowed as a basis of recovery when the LOC clause would otherwise be a bar (i.e., then no modification can be found) then quantum meruit would always be alleged and the LOC would never be effective. Therefore, to find otherwise would be to sanction a unilateral change to the contract by the contractor.

Id. at 52.

73. FAR 52.232-20.

74. FAR 52.232-21.

75. FAR 52.232-22.

76. Consolidated Electrodynamics Corp., ASBCA 6732, 63 BCA ¶ 3806 (1963); Clevite Ordnance, Div. of Clevite Corp., ASBCA 5859, 62 BCA ¶ 3330 (1962). But cf. General Electric Co. v. United States, 188 Ct. Cl. 620 (1969); Engelhard Industries, Inc., ASBCA 11448, 68-1 BCA ¶ 6951 (1968). Contractors might also assert, as when cost limits set in LOC clauses are exceeded, quantum meruit/quantum valebant, and implied-in-fact contract theories. See, e.g., Porter v. United States, 204 Ct. Cl. 355; Prestex, Inc. v. United States, 162 Ct. Cl. 620 (1963); A. L. Coupe Construction Co., Inc. v. United States, 134 Ct. Cl. 392, cert. den. 352 U.S. 834 (1956).

77. FAR 32.704 (a)(1).

78. Id.

79. FAR 32.704 (c).

80. See 55 Comp. Gen. 768 (1976).

81. FAR 32.702.

82. FAR 32.703-1.

83. Memorandum, note 58 supra at 101-19.

84. Id. at 101-22.

85. DAR 7-108.3; use restricted in DAR 8-712.

86. DOD FAR Sup. 52.249-7000.

87. See Memorandum from Mr. Rak, Office of the Air Force General Counsel (SAF/GC (Procurement)), to Mr. Mitchell, "Special Termination Costs Clause," July 8, 1981, found at Headquarters Air Force (SAF/GC), Washington, D.C.

88. Senate Rep. No. 93-385, September, 1973.
89. 47 Comp. Gen. 155, 161 (1967).
90. Solar, Div. of International Harvesters Co., ASBCA 20610, 80-1 BCA ¶ 14,303 (1980). See also West Lumber Sales, 270 F.2d 12 (9th Cir. 1959)(contract ambiguity concerning whether parties intended a call or requirements contract).
91. 42 Comp. Gen. 272 (1962).
92. R. Nash and J. Cibinic, I Federal Procurement Law 690 (1977).
93. 42 Comp. Gen. at 277.
94. 47 Comp. Gen. 155, 163 (1967); Comp. Gen. Dec. B-116427, September 27, 1955, unpub.
95. Cf. Comp. Gen. Dec. B-199079, GSA -- Multiple Award Schedule Multiyear Contracting, 84-1 CPD ¶ 46 (1983)(approving GSA's Federal Supply and Service program of multiyear Multiple Award Schedule contracts because, although procuring agencies would generally use appropriated funds, they would use administrative discretion within each fiscal year before placing orders).

96. See 47 Comp. Gen. 155 (1967); cf. 42 Comp. Gen. 272 (1962).

97. See Comp. Gen. Dec. B-170544(3), January 22, 1971, unpub.; Comp. Gen. Dec. B-160783, March 24, 1967, unpub.

98. FAR 16.504 (b).

99. Frazier, Use of Annual Funds With Conditional, Options, or Indefinite Delivery Contracts, 8 A. F. L. Rev. 50, 51-52 (1966).

100. DAR 3-409.1, .2, & .3. See generally, Virden, Indefinite Delivery Contracts, The Gov't Contractor Briefing Paper No. 78-2 (April, 1978) (which states many of the practical problems associated with indefinite delivery contracts, with relevant cases).

101. FAR 11.001.

102. See Willard, *Sutherland & Co. v. United States*, 262 U.S. 489 (1923); *Federal Electric Corp. v. United States*, 486 F.2d 1377 (Ct. Cl. 1973), aff'g *Federal Electric Corp.*, ASBCA 11726, 68-1 BCA ¶ 6834 (1968); *Tennessee Soap Co.*, 130 Ct. Cl. 154, 158 (1954); *Updike, Trustee v. United States*, 69 Ct. Cl.

394 (1930); Sanz School of Languages, ASBCA 9571 & 9572, 1964 BCA ¶ 4257 (1964); Comp. Gen. Dec. B-160063, February 10, 1967, unpub.

103. See Integrity Management International, Inc., ASBCA 18289, 75-1 BCA ¶ 11,235, aff'd on reconsideration, 75-2 BCA ¶ 11,602 (1975).

104. See 47 Comp. Gen. 155, 159 (1967); Radionics, Inc., ASBCA 20796, 77-1 BCA ¶ 12,448 (1977) at 60,312.

105. See, e.g., Navy FAR Sup. 32.702(90).

106. FAR 52.216-18.

107. FAR 52.216-19.

108. FAR 52.216-20.

109. FAR 52.216-21.

110. Id.

111. Id.

112. Id.

113. Id.

114. FAR 52.216-22.

115. See, e.g., 41 CFR 3.350-1.

116. See, e.g., 41 CFR 8.450-1.

117. See Westinghouse Electric Corporation, ASBCA 16414, 73-1  
BCA ¶ 9840 (1972).

118. FAR 52.216-23.

119. FAR 52.216-24.

120. FAR 52.216-25.

121. Id.

122. FAR 52.216-26.

123. FAR 16.702.

124. DOD FAR Supp. 16.702 (b)(71).
125. FAR 16.703.
126. FAR 16.702 (c); FAR 16.703 (c).
127. FAR 16.703 (c)(2).
128. See Comp. Gen. Dec. B-199079, GSA -- Multiple Award Schedule, Multiyear Contracting, 84-1 CPD ¶ 46 (1983); 60 Comp. Gen. 219 (1981). See also Comp. Gen. Dec. B-213489, March 13, 1984, 32 CCF ¶ 72,364.
129. Comp. Gen. Dec. B-184999, May 6, 1977, unpub.
130. The FAR multiyear contract is basically similar to the DAR 1-322 multiyear contract and much of the developed case law will apply. For an excellent discussion of the DAR multiyear contract from the contractor's perspective, see Latham, Multiyear Procurement, The Gov't Contractor Briefing Paper No. 73-2 (1973).
131. FAR 17.102-3 (d)(1)&(2).
132. ITT-Defense Communications Div. v. United States, 197 Ct. Cl. 11, 453 F.2d 1283 (1972); FAR 17.101 ("Cancellation");

see generally, R. Nash and J. Cibinic, I Federal Procurement Law 470-472 nn.1-6 (1977). Changed government needs can result in funds not being made available to the contracting officer, and that is enough to justify a cancellation. *Applied Devices Corp. v. United States*, 591 F.2d 635 (1979).

133. FAR 17.103-1(h).

134. *ITT Federal Laboratories*, ASBCA 12987 69-2 BCA ¶ 7849 (1969) at 36,490.

135. *Id.* at 36,491.

136. FAR 17.103-1 (a).

137. FAR 17.102-3 (a).

138. *ITT Federal Laboratories*, note 134 supra at 36,492.

139. *Id.*, n.6. See 10 U.S.C. § 2306 (g).

140. *Varo, Inc.*, ASBCA 1379, 70-1 BCA ¶ 8099 (1969).

141. *Applied Devices Corp.*, ASBCA 18384, 77-1 BCA ¶ 12,347 (1977).



142. DAR 1.322.1 (b)(5)(iii); FAR 17.102-3 (d)(3). In the Air Force, authority to approve this delegation is retained by HQ USAF/RDC. Air Force FAR Sup. 17.102-3.

143. DAR 1-322.1 (h); cf. FAR 17.103-1 (f): "Cancellation charges need not be funded before cancellation. If cancellation occurs, the contractor is entitled to payment. . ."

144. FAR 17.101 ("Cancellation ceiling").

145. FAR 17.103-1 (d).

146. DOD FAR Supp. 17.103(70).

147. FAR 17.103-2 (b)(2).

148. FAR 17.103-3 (e); this procedure is identical to that required by DAR 1-322.3(h).

149. See, e.g., 41 CFR § 1-12.904-3.

150. FAR 17.103-1 (b); Comp. Gen. Dec. B-195260, July 11, 1979, unpub. (multiyear lease); Comp. Gen. Dec. B-176325, December 21, 1972, unpub.; Comp. Gen. Dec. B-167250, November 13, 1969, unpub.; Comp. Gen. Dec. B-165013, January 16, 1969,

unpub.; 43 Comp. Gen. 657 (1964).

151. See FAR 17.102-1 (a); 17.103-1 (b)(1).

152. DOD FAR Supp. 17.104-70 & 71.

153. R. Nash and J. Cibinic, I Federal Procurement Law 691 (1977), citing I Report of the Commission on Government Procurement 27 (1972).

154. GAO Report No. PSAD-78-54, "Federal Agencies Should Be Given General Multiyear Contracting Authority For Supplies and Services," January 10, 1978.

155. See, e.g., 10 U.S.C. § 2306 (g).

156. 36 Comp. Gen. 683, 685 (1957); cf. 48 Comp. Gen. 494 (1969).

157. Cf. 20 Comp. Gen. 95 (1940).

158. FAR 52.217-1.

159. FAR 52.217-2.

160. Id.

161. FAR 17.104-4. See, e.g., Comp. Gen. Dec. B-169894, January 5, 1971, unpub. (multiyear requirements contract).

162. Id. at 17.104-4 (b)(3)(i).

163. FAR 17.103-70 (b); 17.101 ("Multiyear contracts"). Including the unamortized nonrecurring costs, but not including, unamortized nonrecurring costs in the termination liability funding.

164. FAR 17.102-2 (a); DOD FAR Supp. 17.102-2 (a) & 17.103-70 (a).

165. FAR 17.103-2(d).

166. FAR 17.101 ("Advance acquisition").

167. FAR 17.101 ("Multiyear acquisition").

168. Dews & Rich, "Multiyear Contracting for the Production of Defense Systems: A Primer," RAND Note No. N-1804-AF at 22-23 (1982).

169. Id. at 30.

## Conclusion

In recent years, rational agency planning to fulfill assigned national policy objectives increasingly has required forecasting beyond the next budget year. The agencies' forecasting efforts are complicated both at the beginning and the end of their annual planning, programming and budgeting cycles.

At the beginning of their PPBS cycles, constantly changing needs require continual reprioritization of programs and reallocation of resources expected to be made available by the Congress to meet the stated requirements of the budget year. At the end of their PPBS cycles, the resulting administrative balance of needs, programs and resources is apt to be upset by congressionally-imposed limitations on the often inadequate resources provided in the congressional budget.

The fact of changing needs is often beyond the control of the agencies. In the case of the Department of Defense, the fact that a national defense must be provided is incontrovertible -- the very survival and basic well-being of the Nation is daily at stake, as is the Nation's ability to

protect and promote our vital interests around the world -- but the nature and variety of threats that we must be prepared to defend against is utterly beyond our control. Within the Department of Defense, our use of such resources as the Congress provides can be more carefully husbanded by more rigorous prioritization of programs to ensure that the most vital programs can be adequately funded to permit the most economic use of resources provided.

Only the Congress can ensure that proper policy direction is furnished the agencies without unnecessarily detailed interference in administrative execution of agency programs the Congress has approved, and only the Congress can discipline its use of the national policy-making power and its internal budget processes to ensure that resources are provided to the agencies each year in time to prevent wasteful program disruptions. The solution to the first problem lies in the Congress voluntarily abstaining from imposing the detailed supervision of agency programs, except in the most unusual cases, that has so burgeoned in recent years. The solution to the second problem lies largely in the Congress preventing the attachment of politically-sensitive riders on appropriations bills, and perhaps also in some procedural change to the congressional budget process that would require a longer time horizon and permit greater program stability. These problems are obvious, but only the Congress can solve them.

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FISCAL LAW INCREMENTAL FUNDING AND CONDITIONAL  
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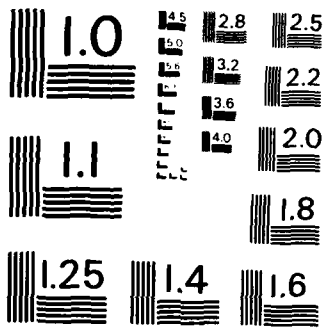
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their solutions.

In the meantime, agencies must meet the demands of the annual budget cycle and retain their flexibility to respond to changing needs, as well as fluctuating and restricted resources, while still stabilizing their most important procurement programs to achieve the greatest economies in necessary acquisitions. Stabilization is necessarily preceded by a voluntary congressional and administrative abstinence from program changes that do not spring from the stabilized programs themselves, or from changes in the national needs that the programs are designed to satisfy.

The full funding policy increases program stability at the expense of program diversity. More programs could be undertaken if acquisitions were more widely incrementally funded, but the nature of the relationship between the Legislative and Executive Branches seems to militate against any shift from full funding of procurements. Program stability seems a prerequisite to incremental funding. If the Congress chooses to continue to override administrative end quantity choices, the risk of waste deriving from early acquisition of economic order quantities of parts, materials, components and associated labor, or from program stretchouts or terminations becomes too great. A reasonable balancing of the virtues of full funding and incremental funding might lie

in the permitting the conscious assumption of at least unbilled cancellation liability in multiyear procurements and advance procurements as unfunded contingent liabilities. Alternatively, the Congress should seriously consider the use of multiyear funding, providing stable multiyear authorization and appropriations, perhaps coupled with advance appropriations earmarked for future years, at least for selected major acquisition programs. Clearly, a fuller use of multiyear procurement by all agencies should be authorized, specifically permitting the use of annual funds to erase any restraining effect of a more expansive application of the antideficiency laws, or the derivative bona fide needs rule.

Finally, existing contractual techniques for contracting before appropriations should continue to be fully used.

**END**

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