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A LAWYER'S VIEW OF REPLACEMENT CONTRACTS

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Replacement Contracts - An Old Dog and Some New Tricks

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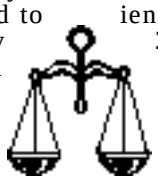
An Old Rule — What happens when a contract is terminated for default, there are still funds obligated but unexpended on the contract, and the need for the original object of the contract still exists? The answer, since 1902, has been the use of a replacement contract.

The replacement contract theory is designed to address problems posed by time limitations on appropriations. Suppose that you have one year or multiyear funds obligated on the contract to be terminated. Suppose further that the original obligational availability of these funds has expired. Under customary fiscal law principles, if you deobligated these funds upon the termination of the contract, they would no longer be available for new obligations. However, you may still have a need for the objects you intended to procure in the terminated contract. If customary rules were followed, new funds would be needed in order to enter into a new contract.



Recognizing this dilemma early on, in a case involving a Patent Office contract for steel book cases, the Comptroller of the Treasury first enunciated the replacement contract theory. 9 Comp. Dec. 10, 11 (1902). The basic rule was later adopted by the Comptroller General and has been closely followed since that date. Essentially, the rule is that where contract performance has extended beyond the period of availability for obligation of an appropriation and the contract has to be terminated because of the contractor's default, funds obligated under the original contract are available for the purpose of a replacement contract to complete the work. *Lawrence W. Rosine Co.*, 55 Comp. Gen. 1351, 1353 (1976).

Three Conditions — There are three conditions which must be met before the funds can be used. First, a bona fide need for the work, supplies or services must have existed when the original contract was executed, and it must continue up to the award of the replacement contract. Id.; *Letter to the Sec'y of the Interior*, 34 Comp. Gen. 239, 240 (1954).

Second, the replacement contract must not exceed the scope of the original contract. *Letter to the SBA Administrato*r, 44 Comp. Gen. 399, 401 (1965). For example, additional quantities in excess of quantities fixed in the original contract would not be within the scope of the original contract and must be treated as a new obligation chargeable to current funds. *Manavox-Use of Contract Underrun Funds,* B-207443 (Sept. 16, 1983). Similarly, contracts for the operation and maintenance of computer systems which had to be used because a contract for the conversion of an accounting system from one computer systems to another was terminated for default were not replacement contracts. *Department of Interior-Disposition of Liquidated Damages Collected for Delayed Performance*, B-242274 (Aug. 27, 1991).

Finally, the replacement contract must be awarded within a reasonable time after termination of the original contract. *Funding of Replacement Contracts*, 60 Comp. Gen. 591, 593 (1981). When the original contract is not terminated until more than three years after the originally scheduled delivery date and award of the replacement contract is delayed by several months, an unreasonable delay has occurred. *Letter to the Sec'y of Treasury*, 32 Comp. Gen. 565, 566 (1953).

Recent Developments — It was long held that the replacement contract theory did not generally apply to those cases where a contract was terminated for convenience. E.g., 60 Comp. Gen. at 595. One early exception to this principle allowed the use of funds when the default termination was found to be erroneous and was converted to a termination for convenience by agreement of the parties. 34 Comp. Gen. at 240.

Within the last five years, however, three cases have further refined the theory. First, the Comptroller General found that a modification of a contract to delete items does not permit the agency to enter into a new contract for these items by using the funds from the old contract. *Tacoma Boatbuilding Co.*, 66 Comp. Gen. 625, 657 (1987). An essential element of the replacement contract rule is that the failure by the original contractor to complete performance must be beyond the agency's control. Modifications do not fit this requirement.

In the next year, the Comptroller General decided that if a contract is terminated for convenience in response to a court order or determination by another competent authority, such as the GAO or GSBCA, that the contract award was improper, then funds from that contract may be used to fund a replacement contract. *Funding of Replacement Contracts*, 68 Comp. Gen. 158, 162 (1988). The rationale is that the agency had no choice but to terminate the contract. Finally, last year, the rule in Replacement Contracts was extended to those situations where the contracting officer determines that the contract award was erroneous and must be terminated for convenience. *Navy-Replacement Contract*, 70 Comp. Gen. 230 (1991). As these cases demonstrate, the replacement contract theory still plays a vital, and evolving role in procurement law. Watch this space for further developments.

From the Editor: This LV is the swan song of Les Viguerie, who is leaving the Department for an appointement in the Foreign Service. The Division will miss Les and wishes him the best in his new career. Comments, criticisms, and suggestions for future topics are welcome. - Call Jerry Walz at FTS (202) 377-1122 or Banyan -Jerry Walz@OGCMAC@OSEC