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DECISION THE COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

FILE: B-201072 **DATE:** May 12, 1983

MATTER OF: Assumption by Government of Contractor Liability to Third Persons - Reconsideration

DIGEST:

1. Public Contract Law Section (PCLS), American Bar Association urges reconsideration of B-201072, May 3, 1982, in which we held that a clause for use in cost reimbursement contracts entitled "Insurance-Liability to Third Persons," appearing in Federal Procurement Regulations § 1-7.204-5, violates the Antideficiency Act, 31 U.S.C. § 1341. PCLS sees no violation on face of clause because agencies are bound to contract in accordance with law and regulations and have adequate accounting controls to prevent such violations. GAO points out that it is impossible to avoid violation if clause is used as written because maximum amount of obligation cannot be determined at time the contract is signed. May 3 decision affirmed.

2. In B-201072, May 3, 1982, GAO recommended modified indemnity clause to avoid violation of Antideficiency Act, 31 U.S.C. § 1341. Modification would limit Government liability to amounts available for obligation at time loss occurs and that nothing should be construed to bind the Congress to appropriate additional funds to make up any deficiency. PCLS says this gives contractor an illusory promise because appropriation could be exhausted at time loss occurs. GAO agrees. Modification could be equally disastrous for agencies if entire balance of appropriation is needed to pay an indemnity. GAO suggests no open-ended indemnities be promised without statutory authority to contract in advance of appropriations.

3. PCLS believes holding in B-201072, May 3, 1982, conflicts with another line of decisions holding that "Insurance-Liability to Third Persons" clause was valid. Decisions cited by PCLS all involved indemnities where maximum liability was determinable and funds could be obligated or administratively reserved to cover it. B-201072, distinguished and affirmed.

On May 3, 1982, the Comptroller General issued a decision (B-201072) in response to a request from the Department of Health and Human Services (HHS) on the validity of a clause in the Federal Procurement Regulations (FPR) entitled "Insurance-Liability to Third Persons." 1/ The clause is intended for use in cost-reimbursement supply and research and development contracts. It provides virtually complete indemnity to contractors for any liability incurred in the performance of such contracts, in unlimited amounts and without restrictions. We agreed with HHS' assessment that use of the clause in its present form would constitute a violation of the Antideficiency Act, and suggested modified language that would avoid that result. We have now received a letter from the Public Contract Law Section (PCLS) of the American Bar Association, urging reconsideration of that decision. We have carefully considered the arguments presented by the PCLS but are not persuaded that our May 3, 1982 decision was incorrect.

As a general rule, this Office does not render decisions in response to requests from non-governmental entities or from persons not parties to the dispute in question. In this instance, however, we recognize that the PCLS reflects the views of many persons who do business with the Government and who would be directly affected by our decision if all Federal agencies implement it. 2/

1/ The clause reads:

"(c) The contractor shall be reimbursed * * * without regard to and as an exception to the 'Limitation of Cost' or the 'Limitation of Funds' clause of this contract, for liabilities to third persons for loss of or damage to property * * * or for death or bodily injury, not compensated by insurance or otherwise, arising out of the performance of this contract, whether or not caused by the negligence of the Contractor, his agents, servants, or employees * * *." FPR Section 1-7.204-5.

2/ Our May 3 decision was primarily concerned with the clause found at FPR §§ 1-7.204-5 and 1-7.404-9. However, we noted that the use of the same clause in the same types of contracts is provided for under Defense Acquisition Regulations §§ 7-203.22 and 7-402.26. Therefore, a wide segment of the Government procurement community is affected.

The PCLS urges reconsideration of the May 3 decision "because of the de-stabilizing effect it will have on the time tested allocation of risks between the contractor and the Government." Its principal arguments are summarized as follows:

1. A. The May 3 decision upset a 40-year practice. In 1943, the Comptroller General specifically approved use of this type of clause.

   B. The May 3 decision conflicts with a long line of opinions relating to the same clause.

   C. The clause has been used by procurement agencies who were fully aware that it conflicted with other "unrelated" cases.

2. There is no Antideficiency Act violation on the face of the "Insurance-Liability to Third Persons" clause.

3. The modification recommended by GAO is a "naked promise because an appropriation may be exhausted at the time a loss occurs."

These arguments are discussed in the order presented below.

1. A. The present "Insurance-Liability to Third Persons" clause was specifically approved by the Comptroller General in 1943.

The PCLS refers specifically to 22 Comp. Gen. 892 (1943), which it characterizes as holding that the indemnity against liability may be considered a "necessary incident" to the placement of a cost reimbursement contract. It adds:

> "The underlying legal doctrine was that the appropriation properly obligated under that contract could by implication be deemed to cover, subject to the amount available therein, the cost of any indemnity and the expenses of completion of the contract work." (Emphasis added.)

In the view of the PCLS, this is directly contrary to our May 3 decision.

We see no such conflict. The 1943 decision responded to a question from the Chairman of the United States Maritime Commission. At that time, the Commission was using contractors to perform trials and tests on the seaworthiness of its vessels. The contractors

were required to take out "public liability" insurance against damages or losses inflicted on third parties. The Commission was reimbursing the contractors for the insurance premiums. The precise question asked was whether the Commission could, in effect "self-insure;" that is, whether it could amend its existing contracts to stop paying insurance premiums and instead agree to indemnify the contractor for any liability to third parties, whether caused by negligence of a contractor's employee or otherwise.

The Comptroller General replied (in paraphrase):

> "That's reasonable enough, if you stop paying the insurance premiums, but if you amend your existing contracts to so provide, you cannot agree to pay more in indemnity than the amount presently covered by the existing insurance contracts."

In addition, as the PCLS acknowledges in the portion of its submission previously quoted, any new obligations for indemnification were authorized only "to the extent appropriations are available therefor."

A careful reading of the 1943 decision and the kind of indemnity it sanctioned thus shows two important differences from the "Insurance-Liability to Third Persons" clause at issue. First, the amount of the Government's liability was limited to a precise amount--the amount of liability covered by the contractors' existing public liability insurance,--and second, the amount of the indemnity could not exceed available appropriations. In contrast, the present clause is totally "open-ended;" that is, no maximum liability is either stated or ascertainable by reference to some other document. In addition, no attempt is made to limit Government liability to the amounts available in its appropriation at the time the contract was made or at any other time. In fact, the indemnity obligation is specifically made an exception to the Limitation of Cost or Limitation of Funds clause of the contract which would otherwise be applicable.

B. The PCLS claims that our May 3 decision conflicts with earlier Comptroller General opinions relating to the same clause. Specifically, it cites (in addition to 22 Comp. Gen. 892, discussed above) 20 Comp. Gen. 632 (1941); 21 Comp. Gen. 149 (1941); and 59 Comp. Gen. 705 (1980).

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

The 1980 decision, 59 Comp. Gen. 705, appears, on first reading, to support the PCLS contention. The Comptroller General did permit the General Services Administration (GSA) to agree to an open-ended and unrestricted indemnity to a public utility providing electric power to a Government agency under the Federal Property and Administrative Services Act. On closer reading, however, it becomes apparent that the Comptroller General carved out a very limited exception to a general rule prohibiting such indemnities.

GSA had been receiving power for many years under general tariff provisions that incorporated the same indemnification provision for all customers of the utility. When GSA was offered a more advantageous individual contract, it sought to drop the indemnity provision, in keeping with previous GAO decisions, including a decision issued only a few months earlier to the Department of State (59 Comp. Gen. 369 (1980)). The public utility insisted on the indemnity and there was no other source from which the Government could obtain the needed utility services. The Comptroller General agreed to permit the indemnity clause, but carefully pointed out that the case was not to serve as a precedent.

This was made very clear a few months later when the Architect of the Capitol sought to use a similar clause in an agreement with the Potomac Electric Power Company to install and test certain equipment designed to monitor the use of electricity for conservation purposes. The Comptroller General refused to follow 59 Comp. Gen. 705 because the Architect's situation did not fall within the "narrow exception created by the GSA decision." B-197583, January 19, 1981. PEPCO, it was pointed out, did not have a monopoly on the services desired.

C. The PCLS acknowledges that there is a long line of Comptroller General decisions that state:

> "Absent specific authority, indemnity provisions in agreements which subject the United States to contingent and undetermined liabilities may contravene the Antideficiency Act."

However, the PCLS terms this line of decisions "unrelated," and in any case, it asserts that until our May 3, 1982 decision was issued, there was "no basis to believe that these two distinct lines of Comptroller General decisions would intersect and clash with each other."

As was previously pointed out, there is no clash that we can discern. Except for the 1980 utility case, discussed above, the accounting officers of the Government have never issued a decision sanctioning the incurring of an obligation for an open-ended indemnity in the absence of statutory authority to the contrary.

This line of cases stretches back to the days before this Office came into existence. In 15 Comp. Dec. 405 (1909), the Comptroller General's predecessor, the Secretary of the Treasury, wrote a stern reply to the Secretary of Commerce and Labor, who had asked whether his agency could indemnify a railroad against any liability for accidents or injuries arising from the use of "velocipede" cars by Government employees along the railroad tracks. The Secretary of the Treasury said:

> "Under the [Antideficiency Act], no officer of the Government has a right to make a contract on its behalf involving the payment of an indefinite and uncertain sum, that may exceed the appropriation and which is not capable of definite ascertainment by the terms of the contract, but is wholly dependent upon the happening of some contingency, the consequences of which cannot be defined by the contract."

The line of decisions applying this general principle stretches, unbroken, right up to the May 3 decision at issue. See, for example, 7 Comp. Gen. 507 (1928); 16 Comp. Gen. 803 (1937); 20 Comp. Gen. 95 (1940); A-95749, October 14, 1938; 35 Comp. Gen. 85 (1955); 59 Comp. Gen. 369 (1980); B-197583, January 19, 1981. See also, California-Pacific Utilities Co. v. United States, 194 Ct. Cl. 703, 715 (1971).

It should be noted that not all indemnity contracts are proscribed. As pointed out earlier (in discussing the cases that the PCLS thought were in conflict with our May 3 decision), we have never objected to an indemnity where the maximum amount of liability is fixed or readily ascertainable, and where the agency had sufficient funds in its appropriation which could be obligated or administratively reserved to cover the maximum liability. See 42 Comp. Gen. 708 (1963) (overruled in part by 54 Comp. Gen. 824 (1975) with respect to the need to reserve funds); B-114860, December 19, 1979; 48 Comp. Gen. 361 (1968). See also 54 Comp. Gen. 824 (1975), which set forth the rules under which the Government may, in limited circumstances, assume the risk of damage to contractor-owned property used in the performance of its contract with the Government.

Another category of permissible indemnity contracts is those which are protected by a statutory umbrella. The most common example is defense-related contracts which come under 50 U.S.C. § 1431 (often referred to by its Public Law designation, Pub. L. 85-804). There are other statutes that exempt contracts for extra-hazardous activities related to nuclear energy or to the administration of swine flu vaccine. These statutes constitute statutory exceptions to the Antideficiency Act. They confer what might be termed "contract authority" - i.e., authority to commit the Government to future obligations even though no appropriations are available to pay the obligation at the time the contract is made. Such authority was given in each case after full consideration by the Congress of the country's national security or other needs which could not be obtained without permitting this type of indemnity. We have no problem with this principle. It is our view, however, that statutory exceptions should be made by the Congress and not by the executive branch. (See later discussion in response to question 3.)

2. There is no Antideficiency Act violation on the face of the "Insurance-Liability to Third Persons" clause.

The PCLS appears to be quite familiar with the provisions of the Antideficiency Act, subsection (a) of which is now codified at 31 U.S.C. § 1341. It is, therefore, unnecessary to repeat its text here, except to emphasize that the Act prohibits the incurring of any obligation for the future payment of money in advance of or in excess of appropriations adequate to cover it. If the maximum liability is determinable, it is possible

to set aside sufficient funds to meet the obligation if and when it occurs. The clause in question, however, promises an indemnity for property damages, death, or bodily injury. Who can set a maximum price, at the time the indemnity obligation is incurred, on a human life or predict the amount of a court award for serious injury or other dire consequences arising from the performance of a contract? We find that the clause, on its face, commits the Government to pay at some future time an indefinite sum of money should certain events happen. There is no possible way to know at the time the contract is signed whether there are sufficient funds in the appropriation to cover the liability if or when it arises because no one knows in advance how much the liability may be.

The PCLS appears to base its contrary argument on the fact that agency regulations adjure all contracting officers to adhere to "all applicable requirements of law, Executive orders and regulations * * *." According to PCLS, this means:

> "Contracting officers have entered into cost-reimbursement type contracts in accordance with applicable provisions of law, as interpreted by, among others, the Comptroller General. Moreover, it would appear Anti-Deficiency Act violations may be barred through the accounting controls established by the procuring agencies for this purpose."

Unfortunately, regulations like accounting controls, are not always followed. Moreover, as explained above, no matter how well intentioned, an agency's contracting and fiscal officers who use the clause as written could not possibly adhere to the requirements of the law or their own accounting controls because they cannot determine the extent of the obligation they are incurring at the time the contract is signed. We therefore affirm our holding in B-201072, May 3, 1982 that the "Insurance-Liability to Third Persons" clause is invalid because, as written, it violates the Antideficiency Act.

3. The modification recommended by GAO is a "naked promise because an appropriation may be exhausted at the time a loss occurs."

GAO recommended in its May 3 decision, among others, that the clause be amended to provide that the indemnity be limited to amounts available in agency appropriations at the time the liability arises, and that nothing in the contract shall be considered to bind the Congress to appropriate additional funds to cover any deficiency. It is the presence of the underlined phrase that disturbs the PCLS.

We agree with the PCLS' observation. A little over a year ago, we issued a decision which illustrates the dilemma well. In B-202518, January 8, 1982, we were asked to approve a payment to the State of New York for injuries to a State militiaman incurred while providing guard services to the Department of the Army for the Winter Olympic Games. Army had included an indemnity clause in the form we recommended (rather than using the "Insurance-Liability to Third Persons" clause permitted by the DAR) in its cost reimbursement support contract with the State of New York. Had the accident happened closer to the end of the fiscal year, it is quite possible that no unobligated balance would have been available to reimburse the State for its Workman's Compensation payments.

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

To sum up, the solution to the problem recommended in the May 3, 1982 decision, among others, prevents an overt violation of the Antideficiency Act but has potentially disastrous fiscal consequences for the Federal agency involved, and may offer only illusory benefits to the contractor. The PCLS solution, which appears to urge us to endorse the "Insurance-Liability to Third Persons" clause, is not acceptable because it amounts to a prima facie violation of the Antideficiency Act.

We have been informally considering a third approach, which we have shared with the Office of Acquisition Policy, GSA, the Director of the Defense Acquisition Regulatory Council, DOD, and the Director, Office of Federal Procurement Policy, Office of Management and Budget. It is our tentative position that even if contract indemnification clauses are rewritten to meet the minimum requirements of the Antideficiency Act, there should be a clear Government-wide policy restricting their use. Since the potential liability of the Government created by open-ended, indefinite indemnification clauses is so great, we think that any

such authority should be viewed as an exception from the basic legislative policy that no Government agency should enter into financial commitments, even though contingent in nature, without an appropriation to cover them. Exceptions to this policy should not be made without express Congressional acquiescence, as has been done in the past whenever the Congress has decided that it was in the best interests of the Government to assume the risks of having to pay off on an indemnity obligation. See, for example, 10 U.S.C. § 2354 (1976); 38 U.S.C. § 4101 (1976); and 42 U.S.C. § 2210 (1976). See also Pub. L. 85-804 and its implementing Executive Order No. 10789, discussed earlier. In other words, our tentative position is that open-ended, indemnification clauses should only be permitted when an agency has been given statutory authority to enter into such an arrangement.

for Milton J. Socolar
Comptroller General
of the United States