



United States  
General Accounting Office  
Washington, D.C. 20548

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Ruppert

Office of the General Counsel

B-252378

September 21, 1993

Mr. James K. White  
Assistant General Counsel for  
Finance and Litigation  
Office of the General Counsel  
Department of Commerce

Dear Mr. White:

This is in response to your request for our advise on whether a contract between the National Oceanic and Atmospheric Administration, National Marine Fisheries Service (NMFS) and the Manomet Bird Observatory Trust (Manomet) violated the prohibition in 41 U.S.C. § 254(b) (1988) against the cost-plus-a-percentage-of-cost system of contracting and, if so, whether Manomet may be reimbursed on a quantum meruit basis. For the reasons stated below, we agree that the contract provides for a method of payment prohibited by 41 U.S.C. § 254(b). Manomet, however, may be reimbursed on a quantum meruit basis.

The contract called for services to be performed pursuant to the Magnuson Fishery Conservation and Management Act, 16 U.S.C. § 1801 et seq. The work consisted of providing supplementary observer services aboard foreign fishing vessels. The agreement provided that the owners and operators of foreign fishing vessels would pay Manomet on a cost reimbursement (no fee) basis. Payment was to include all supplemental observer program direct costs, which included salaries and observer related expenses, plus overhead. The agreement also provided for payment to Manomet of a pre-determined, fixed, 54-percent overhead rate. Moreover, the agreement had no ceiling on the amount of indirect costs that could be recovered with the 54-percent rate. The agreement expired on March 31, 1991, and Manomet completed all required services.

In 1992, the Office of the Inspector General (OIG), U.S. Department of Commerce, reported the results of its audit of the contract between NMFS and Manomet. The OIG found that the contract had attributes of a prohibited cost-plus-a-percentage-of-cost contract and recommended that NMFS seek a legal opinion from Commerce's Office of General Counsel on this matter. In response to NMFS request, your Office

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**DIGEST**

1. Cost-type contract which provides for overhead payment based on a fixed percentage rate of some element of direct cost, but does not provide for retroactive adjustment to actual cost, violates the prohibition of 41 U.S.C. § 254(b) against cost-plus-a-percentage-of-cost since (1) payment is based on predetermined percentage rate; (2) percentage rate is applied to actual performance costs; (3) contractor entitlement is uncertain at time of contracting; and (4) contractor entitlement increases commensurately with increased performance costs.

2. When procurement is invalid due to failure to comply with Federal statute, Government has obligation to pay reasonable value of goods or services furnished upon an implied contract on a quantum meruit or quantum valebant basis.

determined that the fixed 54% indirect rate constituted a cost-plus-a-percentage-of-cost method of contracting. However, based on the services performed and the benefits received by the government and the owners of the foreign fishing vessels, you believe there exists an implied obligation to pay for the services on a quantum meruit basis.

Our Office uses the following criteria to determine whether a method of payment represents a prohibited cost-plus-a-percentage-of-cost arrangement:

- (1) Payment is at a pre-determined rate,
- (2) the pre-determined rate is applied to actual performance costs,
- (3) the contractor's entitlement is uncertain at the time of contracting, and
- (4) the contractor's entitlement increases commensurately with increased performance costs.

Department of State-Method of Payment Provisions, B-196556, Aug. 5, 1980, 80-2 CPD 87; Federation Aviation Administration - Request for Advance Decision, 58 Comp. Gen. 654, 655 (1979), 79-2 CPD 34; Marketing Consultants International Limited, 55 Comp. Gen. 554, 562 (1975), 75-2 CPD 384.

We agree with you and the IG that the contract meets the criteria for a prohibited cost-plus-a-percentage-of-cost arrangement. In this case, (1) the fixed overhead rate was 54 percent; (2) it was applied to Manomet's actual incurred direct costs without a ceiling on the indirect cost reimbursements; (3) Manomet's entitlement was uncertain at the time of contracting; and (4) subsequently, Manomet's entitlement increased commensurate with its increased direct costs. Under these circumstances, we agree that the contract was a violation of 41 U.S.C. § 254(b), which prohibits cost-plus-a-percentage-of cost method of contracting. Furthermore, we have held that the use of a predetermined overhead rate to be applied to some element of direct cost which is undetermined at the time the rate is set, with no provision for retroactive adjustment to the actual cost, violates the express statutory prohibition against cost-plus-a-percentage-of-cost system of contracting contained in 41 U.S.C. § 254(b). Thus, we have held that the practice of reimbursing overhead costs on the basis of such predetermined rates is illegal and should be discontinued. 35 Comp. Gen. 434, 436 (1956).

However, our Office has recognized that where goods are furnished or services rendered but the contract under which the performance occurred is void, an obligation on the United States arises to pay for the value of the goods or service actually furnished upon an implied contract on a quantum meruit/quantum valebant basis. See 58 Comp. Gen. 654 supra.

Commerce reports that the agreement expired on March 31, 1991, and that Manomet completed all the required services. Commerce determined that the government and the foreign vessel owners/operators did receive fair value in services provided for the funds paid to Manomet but that the exact value of the services provided will be determined at a later date. Accordingly, we agree that Manomet may be paid on a quantum meruit basis for the value of the services provided as determined by the Department of Commerce.



Gary L. Kepplinger  
Associate General Counsel