



**Comptroller General
of the United States**

Washington, D.C. 20548

Decision

Matter of: Federal Aviation Administration Negotiations with Pacific Gas and Electric Company to Provide Electric Utility Service to a Remote Air Route Surveillance Radar Facility

File: B-260063

Date: June 30, 1995

DIGEST

1. The Federal Aviation Administration violated 31 U.S.C. § 3324 by making an advance payment to Pacific Gas and Electric Company for connecting electrical utility service to a remote FAA facility. FAA failed to obtain "adequate security" for making advance payments as required by 41 U.S.C. § 255 or to follow the other requirements of the Federal Acquisition Regulations regarding advance payments.
2. The Federal Aviation Administration may pay a connection charge to Pacific Gas and Electric Company to connect electrical utility service to a remote FAA facility that includes an itemization of the increased federal and state income taxes that PG&E will incur incident to the transaction. The enumerated amounts would reimburse PG&E for taxes imposed upon the utility and would not constitute impermissible taxes on the federal government.
3. The Federal Aviation Administration should not accept as part of its agreement with Pacific Gas and Electric Company to connect electrical utility service to a remote FAA facility a clause offering PG&E an open-ended, unrestricted indemnity from FAA. The indemnity clause, through events that FAA cannot control, could produce a liability in excess of FAA's available appropriations in violation of the Antideficiency Act, 31 U.S.C. §§ 1341 and 1517.

DECISION

The Assistant Chief Counsel, Western-Pacific Region, Federal Aviation Administration (FAA), has requested a decision on several issues raised during negotiations between the FAA and Pacific Gas & Electric Company (PG&E). FAA and PG&E are negotiating the amount that PG&E will be paid to connect electrical power to FAA's Rainbow Ridge Air Route Surveillance Radar site in a remote location near Eureka, California.

For the reasons discussed below, we conclude that: (1) the FAA violated 31 U.S.C. § 3324 by making an advance payment to PG&E for the connection of the Rainbow Ridge radar site to PG&E's electrical power lines; (2) FAA may pay a connection charge to PG&E that includes an itemization of the increased federal and state income taxes that PG&E will incur incident to its agreement to connect electrical power to the Rainbow Ridge radar site; and (3) FAA should not accept as part of its agreement with PG&E an open-ended, unrestricted indemnity clause that would require FAA to assume liability for damages that PG&E may incur in providing electrical service to the Rainbow Ridge site.

Background

The FAA (together with the U.S. Air Force) is currently constructing 43 Air Route Surveillance Radar sites across the continental United States to fulfill both civilian and military aviation radar needs. One of these sites is located at Rainbow Ridge, California. The Rainbow Ridge radar site is in a remote location, which has caused some difficulty for the FAA in procuring the electrical power needed to run the facility. In order to obtain power, the Rainbow Ridge radar site must be connected to power lines owned by PG&E, the sole provider of electrical power in the area.

In December 1985, PG&E and the General Services Administration entered into a 10-year term areawide public utilities contract for PG&E to provide utility services to federal government facilities. Under Article 2(b) of the areawide contract, all federal agency procurements of utility services from PG&E were to be made under the contract. The areawide contract generally requires PG&E to provide utility services at PG&E's general tariff rates as approved by the California Public Utilities Commission (Commission). However, Article 2(b) of the areawide contract allows PG&E to provide "services of a special nature" to federal agencies at negotiated rates, provided that such rates and services are allowed by the Commission.

FAA has been in negotiations with PG&E to connect the Rainbow Ridge radar site to PG&E's power line 7 miles away and to thereafter provide electrical service to the radar facility. The record reflects that PG&E considers connecting electrical service to the Rainbow Ridge site to be a service "of a special nature" under the areawide contract. Specifically, PG&E projects that the revenue from the facilities installed to make the 7-mile-long connection to the Rainbow Ridge radar site will not be enough to support its investment in installing the equipment. PG&E thus asserts that the line to the Rainbow Ridge radar site would be an unfair economic burden on PG&E's remaining customers.

Accordingly, as would be allowed under Article 2(b) of the areawide contract, PG&E has offered to connect service to the Rainbow Ridge radar site for a negotiated charge. The charge PG&E seeks includes amounts that will reimburse PG&E for: the costs of constructing the connecting facilities to the Rainbow Ridge

radar site, the increased federal and state income taxes that PG&E will be assessed as a result of having those construction costs reimbursed, and PG&E's ownership costs for the new facilities that will not be recovered by the electrical service rates that FAA pays for electricity used at the Rainbow Ridge radar site.

The record reflects that on March 30, 1992, PG&E offered, under the terms of the areawide contract, to connect electrical service to the Rainbow Ridge site for a connection charge of \$440,438. On May 4, 1993, FAA accepted this offer and made a \$440,438 payment to PG&E. However, the PG&E offer stated that it was conditioned upon acceptance of the agreement by the California State Public Utilities Commission.¹ Since the agreement was never submitted to the Commission for approval, both PG&E and FAA assert that it never took effect.

On August 18, 1993, PG&E notified FAA that it could no longer connect service to the Rainbow Ridge site for the connection charge offered in March 1992. In the resulting negotiations for a new connection charge, FAA became concerned about three aspects of PG&E's offers to connect service to Rainbow Ridge. First, PG&E has asked that the full amount of the connection charges be paid in advance of connecting electrical service to the Rainbow Ridge site. Second, PG&E has stated that the amount of the connection charge must include a reimbursement for the increased federal and state corporate income taxes that PG&E will incur because part of the connection charge will be taxable income to PG&E as a contribution in aid of construction (CIAC). Finally, PG&E's has requested that any agreement to connect and provide service to the Rainbow Ridge site include an open-ended, unrestricted indemnity clause requiring FAA to assume liability for damages that PG&E may incur in providing electrical service to the Rainbow Ridge site. FAA has sought our views on whether it may accept these conditions of PG&E's offers.

Advance Payment

As stated above, in 1993, FAA paid \$440,438 to PG&E in advance of the installation of any connecting power lines to the Rainbow Ridge radar site. FAA also states that throughout their negotiations with PG&E, PG&E has insisted upon advance payment for the full amount of any connection charge. Under 31 U.S.C. § 3324, agencies may not make advance payments on contracts unless the payments are specifically authorized by law.² Under 41 U.S.C. § 255, agencies are authorized to

¹This condition appears to be consistent with the language of Article 2(b) of the areawide contract providing that agreements to provide special services at negotiated rates be for services and rates that are "allowed by the Commission."

²Section 3324 itself authorizes certain advance payments, but none of those authorizations applies in this matter.

make advance payments under contracts for property or services, but they must determine that the advance payment will be in the public interest and must obtain adequate security. Security may be in the form of liens in favor of the federal government on the property being acquired, on the balance of advance funds held by the contractor, or on property acquired for the performance of the contract. 41 U.S.C. § 255(d).

Part 32.4 of the Federal Acquisition Regulation (FAR) implements the advance payment authority of section 255. The FAR states that advance payments are the least preferred method of contract financing for the federal government, and that advances should be made sparingly. 48 C.F.R. § 32.402. The FAR also sets out the types of situations when advance payments may be considered, such as contracts of a highly classified nature where national security interests would make assignment of claims undesirable, or contracts where reasonable commercial financing is not available. 48 C.F.R. § 32.403.

Our review of the record shows that FAA has not complied with the requirements of either 41 U.S.C. § 255 or FAR Part 32.4. FAA apparently has made a \$440,438 payment to PG&E without security or any means of protecting the government's interest. In the course of its continuing negotiations with PG&E, FAA has asserted that PG&E's rate for connecting service to the Rainbow Ridge radar site should take into account the interest earned on the advance payment.³ We do not view this as adequate compliance with the requirements of section 255. Since FAA has not indicated to us any other authority for making an advance payment to PG&E, and we are not aware of any, we conclude that FAA violated the prohibition of 31 U.S.C. § 3324 when it made the \$440,438 advance payment to PG&E.

CIAC Taxes

Although corporations are subject to federal income tax on their gross income "from whatever source derived," contributions to capital of a corporation are specifically excluded from gross income. 26 U.S.C. §§ 61 and 118(a). However, the capital contributions made by customers or potential customers, referred to as contributions in aid of construction (CIACs), are not considered contributions to

³In the alternative, FAA states that PG&E may return the advance payment to the FAA, so that the funds may be deposited in an interest bearing account until PG&E and FAA can agree on a charge for connecting the Rainbow Ridge radar site. We are not aware of any authority that would permit FAA to hold federal funds in an interest bearing account pending final payment to a contractor. In general, refunds of erroneous payments should be credited to the appropriation account initially charged with the payment. See 30 Comp. Gen. 595 (1950).

capital for purposes of the exclusion. 26 U.S.C. § 118(b). Thus, CIACs paid by customers are taxable income to the corporations that receive them.

The Internal Revenue Service has determined that payments made by customers to a public utility to obtain utility services will be treated as CIACs, and thus will be taxable income to the utility. IRS Notice 87-82, 87-2 C.B. 389. Thus, at least some part of the connection charge that FAA would pay to PG&E to make an electrical service connection to the Rainbow Ridge radar site will be income to PG&E that is subject to federal corporate income tax. Further, PG&E's California corporate taxable income is determined in accordance with the federal Internal Revenue Code. Cal. Rev. & Tax. § 17131 (Deering Supp. 1995). Thus the amount of PG&E's CIAC income from the FAA that will be subject to federal corporate income tax will also be subject to California state corporate income tax.

As stated above, PG&E has expressed the view that, because the facilities constructed to provide electrical power to the Rainbow Ridge radar site would be an uneconomic investment by PG&E, FAA should bear the full economic costs of constructing the facilities. Consistent with this view, PG&E has sought to recover the increased corporate income taxes, both federal and state, that it will incur incident to an agreement to connect service to the Rainbow Ridge radar site. FAA has objected to the "CIAC tax" amounts included in PG&E's offered connection charges on the grounds that FAA's appropriations are not available to pay such taxes.

We conclude that FAA's appropriations are available to pay that part of a connection charge that PG&E has itemized as the increased income taxes that PG&E would incur because of its transaction with the FAA. In regard to the increase in California corporate income taxes, our decisions focus in the issue of whether the legal incidence of the tax falls on the federal agency or some other party. 61 Comp. Gen. 257 (1982). If the legal incidence of the tax falls on some other party (often then referred to as a vendor tax), the fact that the economic burden of the tax may fall on a federal agency does not make the tax unconstitutional. *Id.* Thus, we have concluded that a "tax" included as a separate item on a utility bill submitted to a federal agency could be paid if it is merely a reimbursement of a vendor tax assessed on the utility. 32 Comp. Gen. 577 (1953). In such situations, the agency's appropriation is being used to acquire the utility services, not to pay the "tax" itemized on the utility bill.

It is clear that the legal incidence of California portion of the "CIAC tax" that PG&E itemized on its offers to connect service to the Rainbow Ridge radar site falls on PG&E, not on the FAA. As discussed above, the "tax" is really an increase in PG&E's corporate income taxes. Accordingly, our cases would not prevent FAA from paying a charge for connecting electrical service to the Rainbow Ridge radar

site that specifically itemizes the increased state corporate income taxes that PG&E will pay incident to the transaction.

Further, we see no need for any different result regarding the increased federal corporate income taxes itemized by PG&E. As with the net increase in the California corporate income tax, FAA will not bear the legal incidence of any net increase in PG&E's federal corporate income tax. FAA's appropriations will be used for the appropriate purpose of connecting electrical service for the Rainbow Ridge radar site. The fact that the amount which FAA pays will reimburse PG&E for its full costs, including the net increase to its federal income taxes, does not change the nature of FAA's expenditure.

Finally, we note that PG&E's various offers to connect service to the Rainbow Ridge radar site calculate the applicable "CIAC tax" amounts as 34 percent of the costs of installing the connecting facilities that will not otherwise be recovered by PG&E. However, the IRS has stated that the amount that a utility must recover in order to ensure that its ratepayers do not bear the burden of increased taxes incident to a CIAC payment

"may be determined by reducing the amount of tax attributable to the receipt of the CIAC by the present value of the tax benefits to be obtained by depreciating the CIAC property in determining the utility's Federal income tax liability."

1987-2 C.B. at 392. We urge the FAA to ensure that "CIAC tax" portion of the Rainbow Ridge radar site connection charge paid to PG&E is calculated consistent with the IRS description.

Indemnity Clause

As FAA points out, open-ended, unrestricted indemnity clauses in government contracts may involve agencies in violations of the Antideficiency Act, 31 U.S.C. §§ 1341 and 1517. Sections 1341 and 1517 generally prohibit federal officials from incurring obligations in excess of the amounts available. Open-ended, unrestricted indemnity clauses may require the government to make a future payment of an indefinite and uncertain amount, as determined by contingencies that cannot be defined by the contract.

"There is no possible way to know at the time that 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."

62 Comp. Gen. 361, 366 (1983). Because those amounts are uncertain, they may exceed the amounts available to the agency in violation of the Antideficiency Act. Accordingly, in most circumstances such open-ended, unrestricted indemnity clauses themselves constitute violations of the Antideficiency Act. Id. at 367.

The clause proposed by PG&E states, in part, that

"[FAA] shall indemnify and hold harmless PG&E, its officers, agents, and employees against all loss, damage, expense, and liability, resulting from injury to or death of any person, including but not limited to employees of PG&E, [FAA], or any third party, or for loss, destruction, damage to property, including but not limited to, property of PG&E, [FAA], or any third party, arising out of or in any way connected with the performance of this Agreement and any and all construction activities, however caused, except to the extent caused by the active negligence or wilful misconduct of PG&E, its officers, agents and employees."

FAA has concluded, based on our cases, that it should not accept this opened, unrestricted indemnity clause. We agree.⁴

Conclusion

In conclusion, we find that the FAA has violated 31 U.S.C. § 3324 by making an advance payment to PG&E for the connection of the Rainbow Ridge radar site to PG&E's electrical power lines. FAA failed to obtain "adequate security" as required by 41 U.S.C. § 255 or to follow the other requirements of the FAR regarding

⁴While agencies may, under some circumstances, procure power under tariffs containing indemnity clauses, 59 Comp. Gen. 705 (1980), in this case PG&E is seeking an indemnity clause as part of the special, individually negotiated rate to be paid by FAA for connecting service to the Rainbow Ridge radar site, not in a generally applicable tariff. The clause proposed by PG&E would specifically discriminate against FAA. PG&E's areawide contract with the General Services Administration provides:

"The government shall in no event be liable or responsible for damage or injury to any person or property occasioned through the use or operation of the Contractor's Utility Facilities or actions of the Contractor, its employees, or agents, in performing this Contract; provided however that the Contractor shall not be responsible for the negligent actions of the government, its employees, or agents."

advance payments. We also conclude that FAA may pay a connection charge to PG&E that includes an itemization of the increased federal and state income taxes that PG&E will incur incident to its agreement to connect electrical power to the Rainbow Ridge radar site. The reimbursements would cover valid taxes imposed upon PG&E and would not constitute impermissible taxes on the federal government. Finally, FAA should not accept as part of its agreement with PG&E a clause offering PG&E an open-ended, unrestricted indemnity from FAA. The indemnity clause, through events that FAA cannot control, could produce a liability in excess of FAA's available appropriations in violation of the Antideficiency Act, 31 U.S.C. §§ 1341 and 1517.

/s/James F. Hinchman
for Comptroller General
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