

Unauthorized & Illegal Procurements - FAQ

Any attempt to contract by the government will be unsuccessful – and no contract will be formed – if the effort is undertaken by a person lacking actual authority (an “unauthorized” contract) or in a manner that does not comply with the procurement laws (an “illegal” contract).ⁱ If such an error is discovered after the parties begin contract performance,ⁱⁱ the parties are proceeding without a valid contract and some action must be taken to rectify the error. Regulation 19-445.2015 explains how such errors get addressed.

How do I address such errors? Rectifying the errors involves something of a two-step process, though the decisions in each step are intertwined.

Step One: Determine whether to ratify the contract or acknowledge that it is void.

By default, neither unauthorized nor illegal contracts bind the government. Once such errors are discovered, the government must either acknowledge that the attempt to contract failed (the contract is void) or seek to ratify the contract.ⁱⁱⁱ Regulation 19-445.2015 provides a framework for making that decision.

An “unauthorized” or “illegal” contract may be ratified only if ratification is in the “interest of the State.” If ratification is not in the State’s interest, the contract must be acknowledged as void. Determining whether ratification is in the interest of the State requires consideration of the following factors:

- Seriousness of the procurement deficiency;
- Degree of prejudice to the integrity of the competitive procurement system;
- Extent of performance;
- Good faith of the public officials and contractors involved;
- Costs to the State, if any, in either terminating the contract or declaring it void;
- Urgency of the acquisition; and
- Impact on the using agency’s mission.

If ratifying is in the State’s interest, the government must decide whether to continue or terminate the ratified contract.

Why would the State ratify and then terminate a contract? At first blush, it seems counterintuitive to ratify a contract only to turn around and terminate it; however, ratifying a contract you intend to terminate can protect the State if it wishes to preserve contractual rights that have accrued or would accrue prior to termination. For example, if the contract contains a warranty, and the contract was later found void, the State loses the protection of the warranty – none was granted because no contract exists. By ratifying and then terminating the contract, the State preserves those contractual rights that survive termination.

Unauthorized & Illegal Procurements - FAQ

Step Two: Continue performance or terminate the contract? The Regulation applies different decision-making procedures depending on whether the ratified contract was unauthorized or illegal. Unauthorized contracts may be continued or terminated at the appropriate official's discretion. Illegal contracts, on the other hand, *must* be terminated unless the appropriate official determines that "an urgent and compelling need exists that cannot be otherwise met without undue burden on the State." Without such an "urgent and compelling need" the appropriate official lacks discretion to continue the performance of a contract awarded in violation of the procurement rules, i.e., an illegal contract.

What happens if the contract is terminated? If a contract is terminated, the State must, as appropriate and by agreement with the supplier, return delivered supplies for a refund at no cost or subject to a minimal restocking charge. If a termination claim is made, settlement will be handled according to the contract. In the absence of a termination provision, settlement will be based on costs, established in accordance with GAAP, directly or indirectly allocable to the contract up to the date of termination. Profits for work performed will be proportionate only to performance completed at the date of termination and based on projected loss or gain as though performance was complete. Unearned profit is not recoverable.

What happens if the contract is acknowledged as void? If the contract is found void, no further payments may be made, and the State must endeavor to return to the contractor all unused or undistributed supplies delivered under the contract. In addition, the contractor must return the payments it has received minus either (a) its actual costs or (b) the value the State received from the contractor, whichever is greater.^{iv} This effectively requires the contractor to disgorge any profits received through the void contract.

What happens if a contract has been fully performed? If a contract has been fully performed and no obligations—such as a warranty obligation—remain, there is generally no need to ratify a contract or declare it void.^v However, the governmental body should document the situation in writing setting forth the (a) the applicable facts and circumstances, (b) the corrective action taken to prevent recurrence, and (c) the action taken against the individual committing the act.^{vi}

Who makes the decision?

The CPO^{vii} or, within an agency's certification, the head of a purchasing agency.^{viii}

The CPO must concur in the decision if the contract is illegal (as opposed to unauthorized) and its value exceeds either the agency's certification or \$100,000 (whichever is less), unless the contract will be declared null and void.

Also, the CPO must concur in any determination that makes a finding of bad faith.

If the contract has a total potential value no greater than \$100,000, either officer may authorize an appropriate designee^{ix} to make these determinations.

Unauthorized & Illegal Procurements - FAQ

How is the decision documented? All decisions authorized by Sections A (declare void or ratify), B (terminate or continue performance), and E (bad faith)^x of the regulation must be supported by a written determination of appropriateness that discusses (a) the applicable facts and circumstances, (b) the corrective action taken to prevent recurrence, and (c) the action taken against the individual committing the act. Every governmental body must submit a quarterly listing of all decisions made pursuant to these three sections, along with written copies of the determinations. The Materials Management Officer will submit this record to the board annually.

This FAQ is offered only to introduce some of the basic concepts addressed in the regulation governing unauthorized or illegal procurements. Reading this FAQ is not a substitute for carefully studying the regulation. Only the regulation is definitive

Endnotes

ⁱ See, e.g., *Carolina Power & Light Co. v. Darlington*, 315 S.C. 5, 9, 431 S.E.2d 580, 583 (1993) (holding that a fire chief's lack of authorization from the municipality, along with a procedural variance, meant he lacked capacity to enter into a contract and noting that "a person who contracts with [the government] is charged with the knowledge of its limitations and restrictions in making contracts"); *Charleston Television v. S.C. Budget & Control Bd.*, 301 S.C. 468, 475, 392 S.E.2d 671, 675 (1990) (holding a lease made in violation of § 11-35-1590 "is therefore null and void."). Generally, see S.C. Code Ann. § 11-35-4315 (added by 2019 Act No. 41, § 61).

ⁱⁱ The processes outlined in R. 19-445.2015 are simply not applicable until after final award, or in the context of a non-competitive procurement (e.g., sole source), until after a binding contract would have formed but for the unauthorized or illegal conduct. If, in a competitive procurement, a defect is discovered after final award but prior to actual performance, the contract may be ratified pursuant to R. 19-445.2015, but any decision to cancel the solicitation or award would be governed exclusively by R. 19-445.2085C. See, generally, R. 19-445.2015J.

ⁱⁱⁱ Ratification is "[a] person's binding adoption of an act already completed but either not done in a way that originally produced a legal obligation or done by a third party having at the time no authority to act as the person's agent . . ." Black's Law Dictionary (11th ed. 2019).

^{iv} If the Contractor acted in bad faith, the State may recover *all* payments it made, and the contractor will not be entitled to an offset. Bad faith requires specific findings showing deception, dishonesty, reckless disregard of clearly applicable laws or regulations, or deliberate breach of contract scope limits.

^v R. 19-445.2015(H)(3).

^{vi} *Id.*

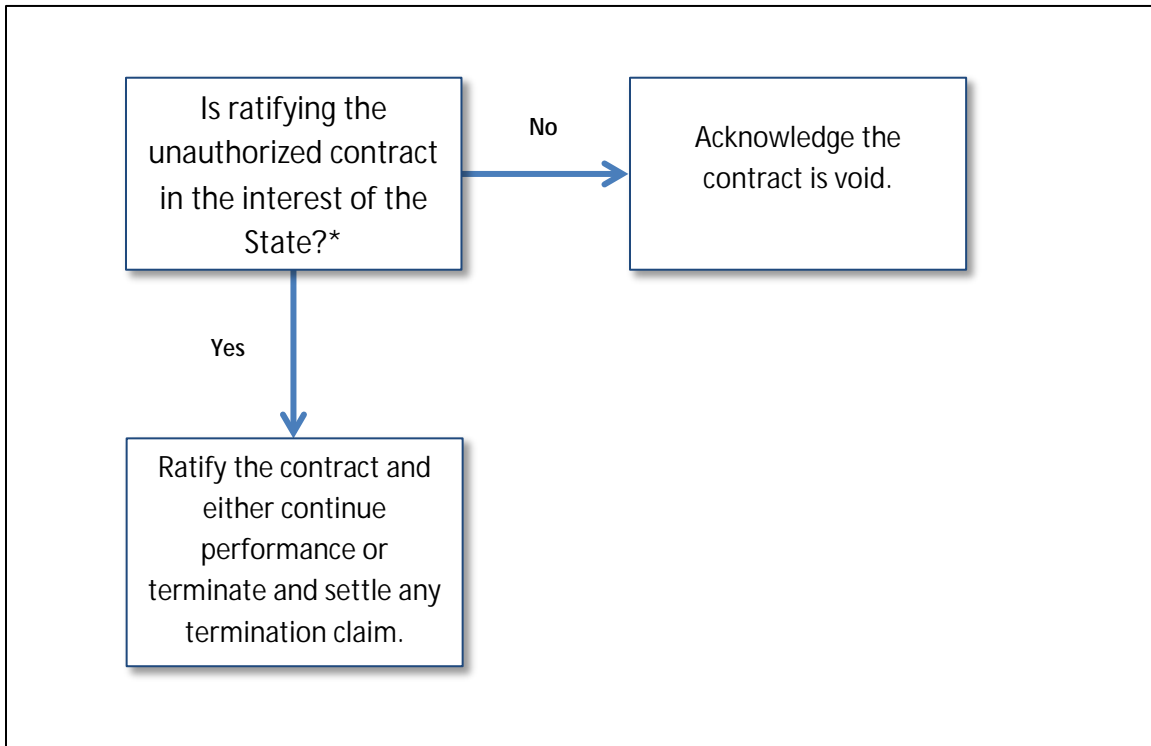
^{vii} For decisions involving using agencies, Regulation 19-445.2000B(1) provides that "[i]n exercising this authority, the chief procurement officers shall afford each using agency reasonable opportunity to participate in and make recommendations with respect to procurement matters affecting the using agency."

^{viii} R. 19-445.1000C(1) defines the phrase "head of purchasing agency."

^{ix} The appropriate designee must be "above the level of the person responsible for the person committing or authorizing the act." In other words, at least two levels above the person who committed or authorized the act.

^x See *In re: S.C. Patients Compensation Fund v. Modus21, LLC*, Panel Case No. 2013-5(III) ("the Panel finds that 'bad faith' under Regulation 19-445.2015(D) requires more than a determination that work was performed outside the scope of the original agreement; there must also be some showing of "dishonest purpose" or "furtive design.").

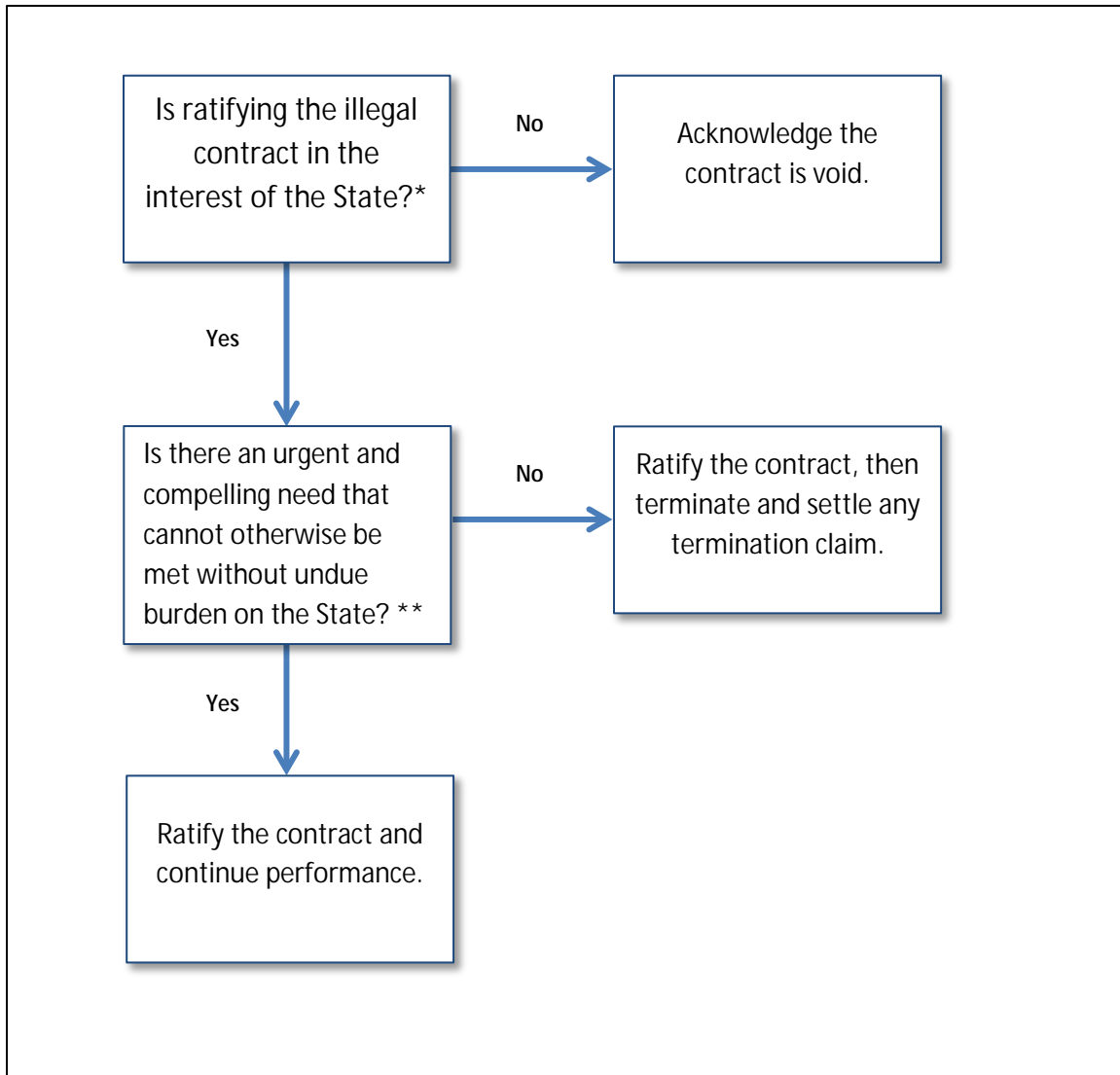
DECISION TREE FOR UNAUTHORIZED CONTRACTS (Attachment A)



*The factors for evaluating whether ratification is in the "interest of the State" include:

- Seriousness of the procurement deficiency;
- Degree of prejudice to the integrity of the competitive procurement system;
- Good faith of the public officials and contractors involved;
- Extent of performance;
- Costs to the State in either terminating the contract or declaring it void;
- Urgency of the acquisition; and
- Impact on the using agency's mission.

DECISION TREE FOR CONTRACTS ENTERED IN VIOLATION OF PROCUREMENT LAWS (Attachment B)



*The factors for evaluating whether ratification is in the "interest of the State" include:

- Seriousness of the procurement deficiency;
- Degree of prejudice to the integrity of the competitive procurement system;
- Good faith of the public officials and contractors involved;
- Extent of performance;
- Costs to the State in either terminating the contract or declaring it void;
- Urgency of the acquisition; and
- Impact on the using agency's mission.

**Possible factors supporting an urgent and compelling need might be the risk of significant adverse consequences, such as costly interrupted service, the disruption of necessary supplies, the disruption to government functions, or where the costs of termination significantly outweigh the costs of continued performance. Even with an urgent and compelling need, the appropriate official must justify why that need cannot be met, without undue burden, by a means other than continuing the illegal contract.