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Knowing Your Cost Principles… RELOCATION COSTS

(Editor's Note. We receive numerous questions about relocation costs. The cost principle, which is more detailed than most, sometimes makes costs unallowable that are normally part of relocation packages offered to employees. Contractors need to understand these provisions so they can identify those relocation expenses provided by the company that need to be screened. Also, some companies choose to align their relocation reimbursement policies with the cost principles. Questions sometimes arise because there are occasional proposals to significantly change the cost principle which up till now have not been passed. For example, in 1998 the government proposed to remove the ceilings on specific relocation costs, provide for a lump-sum payment rather than actual costs and make tax gross-ups and assistance for employee spouses allowable. There are also both allowability and allocability questions. When preparing company written procedures these rules should be taken into account (though not necessarily followed to the letter where, for example, companies may want to provide "tax gross-ups" to employees even though they are unallowable). We have relied on a careful reading of the cost principle, our experience as former government auditors, contractor employees and consultants,, Mathew Bender's "Accounting for Government Contracts" and the DCAA Contract Audit Guidance.)

General Rules

FAR 31.205-35 addresses relocation costs. Relocation costs are incurred when a current employee is reassigned or when a new employee is recruited. A permanent reassignment must be for an indefinite time or if a definite time, no less than 12 months. If an employee who is paid otherwise allowable costs resigns within 12 months for reasons under the employee's control, the relocation costs must either be refunded to the government or credited to the account. Costs for mass relocation of personnel are allowable but the costs should be allocated based on the contracts or time periods benefiting from the costs. So, for example, when a facility is closed and employees are transferred to another site, the costs are to be allocated to the cost objectives at the new location.

Relocation costs that are generally allowable include travel costs of the employee and their immediate family and costs of transporting household and personal effects to the new location. Also, the costs of finding a new home are allowable which includes house-hunting trips by employees and their spouses and temporary lodging which cannot exceed 60 days for the employee and 45 days for spouses and dependents.

Unless relocations costs meet the following three criteria they are unallowable:

1. the move must be for the benefit of the employer;
2. reimbursement must be in accordance either with an established policy or with a practice that is consistently followed and designed to motivate employees to relocate promptly and economically; and
3. employee reimbursement may not exceed actual costs, except that a policy may be established to reimburse employees up to $1,000 for certain miscellaneous expenses (discussed below).

Slightly different requirements exist for relocation of employees who are hired for specific contracts or long term field projects. First, the employment agreement must specifically limit the duration of the employment to the time spent on the specific contract or project. Second, the agreement must provide for the return of the employee to their location before the employment covered by this agreement or to a location of equal or lesser cost.

Specific Requirements

Within certain limits, costs related to disposing of a residence the employee owns at the time of notice of transfer are allowable. Closing costs include (1) brokerage fees (2) legal fees (3) appraisal fees (4) points and (5) finance charges.

Costs of ownership of a vacant former residence that is sold after the employee purchases or leases a new residence are also allowable within limits. These costs

include building and grounds maintenance, utilities, taxes, property insurance, mortgage interest and related items. The combined closing and ownership costs cannot exceed 14 percent of the sales price of the property sold.

Other miscellaneous relocation costs usually considered necessary and reasonable expenses are (1) costs of disconnecting and connecting household appliances (2) automobile registration fees (3) new driver's licenses and use taxes (4) cost of cutting and fitting rugs, draperies and curtains (5) forfeited utility fees and deposits and (6) property insurance for items in transit.

Costs of acquiring a home at a new location are allowable subject to the following and are not expressly unallowable as discussed below. First, the employee must have been a homeowner before relocation. Second, the total costs cannot exceed 5 percent of the purchase price of the new home. Mortgage interest differential payments are also allowable for up to three years provided payments are limited to the difference in the interest rates between the two residences times the current balance of the old mortgage. If the employee transfers again before the three years have passed, the allowable costs are reduced in proportion to the actual relocation period.

Rental differential payments are also allowable. These payments usually arise when a relocated employee retains ownership of a vacated home and rents at the new location. The rented quarters must be comparable to the vacated home. The allowable payment is limited to the actual rental costs less the fair market rental value of the vacated home for three years. The costs of canceling an unexpired lease on vacated premises are also allowable.

Expressly Unallowable Costs

Certain relocation costs are expressly unallowable. These include:

1. a loss on the sale of a residence
2. mortgage principle payments on the old residence
3. payments for employee income or social security taxes incident to reimbursed relocation costs (so-called tax gross-ups)
4. payments for job counseling and placement assistance for spouses and dependents who were not contractor employees at the old location
5. costs incident to furnishing loans to employees or arranging for below-market mortgage loans.

Also unallowable are brokers' fees and commissions, litigation costs, real and personal property insurance, mortgage life insurance, owner's title policy insurance when such insurance was not carried by the employee on the former residence and property taxes and operating or maintenance costs related to acquiring a home in a new location.

DCAA Audit Guidance

Chapter 7-1004 of the Defense Contract Audit Manual (DCAM) addresses employee relocations costs. In addition to merely reflecting the FAR, one can reasonably assert the points emphasized in DCAM actually adds elements to the cost principle. We recommend your human resources and project manager personnel become familiar with this section when considering policies, employee agreements and relocation plans. The guidance contains seven sections summarized below:

7-1004.1. General. This section states FAR 31.205-35 addresses relocation costs and applies to costs incident to permanent changes of duty assignments of not less than 12 months. It identifies eight types of costs that are usually associated with relocation costs – (1) travel and transportation of household goods (2) advanced trips to find a permanent residence (3) closing costs incidental to sale of prior residence (4) miscellaneous expenses such as cancelling a lease or disconnecting and reinstalling appliances (5) acquiring a new house (6) continuing mortgage interest at the old residence (7) interest differential between the old and new mortgage and rental differential where relocated employee retains ownership of a vacated house in the old locations and rents at the new location and (8) other miscellaneous expenses. Travel costs associated with relocation should be considered allowable per diem costs in accordance with FAR 31.205-46, travel costs.

This section stresses that the auditor should evaluate the contractor's policies and procedures and employment agreements to assure they are reasonable and in compliance with FAR requirements. In addition to ensuring they are allowable, the auditor should assure the contractor's allocation methods provide the costs are properly allocated to benefiting contracts with special attention to whether they are charged to the appropriate business segments. The auditor should test whether these policies and procedures are adhered to and if the contractor's policies and procedures are inadequate, additional tests of individual vouchers should be conducted.

7-1004.2. Conditions for allowability. This section focuses on the meaning of the 12 month threshold period. Relocation must involve a permanent change of duty assignment or for an indefinite period as long as more than 12 months are expected. The auditor should question relocation costs "in excess of constructive temporary duty assignment costs" if the contractor should have known at the time of assignment it would not have continued for a period of 12 months or more.

Failure to fulfill a permanent change of duty requires the contractor to refund or credit the cost charged to the government. The auditor is told to encourage contractors to include recapture provisions in their relocation agreements with employees and that this provision should be monitored by the auditor to assure the contractor adequately collects refunds from employees and these refunds are credited to the government.

The guidance states the recapture rule is not applicable to new employees who are (1) hired specifically for long term (at least 12 months) field projects or contract assignments (2) entitled to a return relocation under the terms of their employment contract and (3) not permanent employees and are released from employment upon completion of their assignment. All three conditions are required to meet the recapture waiver so, for example, existing employees reassigned to field projects do not apply.

7-1004.3. Applicability of Joint Travel Regulations (JTR). JTR per diem rates for lodging, meals and incidentals are to apply to employees traveling on official business which includes house-hunting trips and travel to new duty stations. JTR per diem rates do not apply to temporary quarters allowances because employees are not considered to be on official business travel while in temporary quarters.

7-1004.4. Employee assignments not considered relocations. Certain duty assignments, principally overseas locations, often include "location allowances." These "location advances" are considered inducements to work at these locations and should be considered additions to normal wages and salaries covered by FAR 31.205-6, "compensation for personal services" and not relocation costs. Also, costs of travel to overseas locations should be considered travel not relocation if dependents are not permitted and the expenses do not include costs of transporting household goods. Under these circumstances, the move is considered a temporary rather than permanent change of duty station.

7-1004.5. Unallowable relocation costs. The guidance reflects the type of costs in FAR 31.205-35(c) identified above. The section does state the contractors should not be compelled to refund or credit relocation costs for less than 12 months of relocation when the termination of employment was due to illness, disabling injury or death.

7-1004.6. Mass relocations. The guidance alludes to FAR 31.205-35(e) that states both reasonableness and allocation questions may arise over large scale or mass relocations and stresses that when an advanced agreement is not in place FAR 31.2 should be used by the auditor to determine reasonableness and allocation of costs. When the auditor learns of impending mass relocation costs they are told to report the matter to the cognizant ACO and recommend an advanced agreement be prepared for allowability of costs that addresses (1) the appropriate segment where the costs should be allocated (2) length of time over which the costs are to be amortized and (3) eligible employees.

7-1004.7. State and local transfer tax. When a state or local government imposes a tax on the sale of a home by law, the guidance in FAR 31.205-35(a)(3) allows the costs. However, if an agreement to pay the tax is not imposed on the seller (i.e. employee) by law but is agreed to in order to help make the sell or other reasons, the tax is not considered a legitimate closing cost and is to be questioned by the auditor.

LACK OF "BENEFIT TO THE GOVERNMENT" IS NO LONGER GROUNDS TO DISALLOW COSTS

(Editor's Note. In the last few years, we have been seeing both Board decisions and auditors rejecting the allowability of a variety of costs based on assertions the costs "do not benefit the government." In both our consulting engagements and writings we have been quite critical of this trend and the following case comes close to vindicating our criticism.)

Rockwell paid out a total of $25.5 million in civilian and criminal fines to settle allegations involving a civil False Claims Act lawsuit, criminal charges for making false statements under government contracts, defective pricing and environmental violations. Shareholders brought suit (*Citron v. Beal, No. C728809*) against the Rockwell directors and officers alleging they had

breached their fiduciary duties by failing to establish internal controls sufficient to ensure business was carried out in a lawful manner. Between 1989 and 1991, Rockwell incurred about $4,576,000 in various legal and other fees defending against the shareholder suit. It included these costs in its home office G&A pool and claimed reimbursement for a portion of the costs on its various government contracts. When the contracting officer denied these costs, Rockwell appealed to the Armed Services Board of Contract Appeals (ASBCA).

While the appeal was pending before the board, the Federal Circuit decided a case *Caldera v. Northrop Worldwide Aircraft Services Inc., 192 F.3e 962 (1999).* The case also involved legal costs that were incurred in defense of an action charging that the contractor wrongfully terminated several employees because they refused to participate in fraud against the United States (72 FCR 355, 520, 633). The Northrop court concluded the costs were not allowable because they were not allocable under FAR 31.201-4(b) which states " a cost is allocable to a Government contract if it…benefits both the contract and other work, and can be distributed to them in reasonable proportion to benefits received." The Court found recovery of the costs should be barred "because the government did not benefit from defense of the wrongful termination lawsuit".

Citing the *Northrop* case, the Board concluded that Rockwell's legal costs were unallowable because there could be "no benefit to the government in a contractor's defense of a third party lawsuit in which the contractor's prior violation of federal laws and regulations were an integral element of the third party allegations." The board reasoned that "but for" Rockwell's wrongdoing, the *Citron* suit would not have been brought and the costs would not have been incurred.

Rockwell (later succeeded by Boeing who bought out Rockwell) appealed to the Federal Circuit court. The Appeals Court stated the Board's decision erroneously confused allowability with allocability and ruled a cost cannot be considered unallowable because it does not "benefit the government." Whether a cost is allowable or not is based on public policy decisions or contract stipulations where specific regulations such as the FAR cost principles govern. The word "benefit" stated in FAR 31.201-4 is an "allocation" concept and the Court admitted its prior rulings in *Northrup* had "caused confusion." The word "benefit" as used in FAR 31.201-4 refers only to an accounting concept which describes the "nexus" required between the cost and the contract to which it is allocated; it does not impose a separate requirement that a cost must benefit the government's interest for it to be allowable. "The requirement of a 'benefit' to a government contract is not designed to permit…an amorphous inquiry into whether a particular cost sufficiently benefits the government so that the cost should be allowable." The question of allowability is to be based upon "specific allowability regulations."

Though the Court rejected the use of the confusing criteria of "benefit" for determining cost "allowability", Boeing is not out of the woods in its lawsuit costs appeal. The Court stated FAR 31.205-47 reflects a policy judgement that where an action is brought by a government entity and the defense costs would be disallowed because, for example, the proceeding brought a criminal conviction or a civil liability for fraud then the defense costs likewise in a settlement situation should be disallowed unless the government specifies otherwise. Such a relationship would exist if, for example, there was a Court decision that Rockwell directors had failed to maintain adequate controls to prevent wrongdoing against the government. Since the *Citron* case was settled without a judicial decision, there was no such determination. The Court ruled FAR 31.205-47 and the *Northrup* case state that legal defense costs are unallowable when the underlying suit has merit while the costs are allowable when the suit lacks merit. Here, where there was a settlement, the Court ruled that the contractor must show the underlying lawsuit had "very little likelihood of success on the merits" to allow recovery of the legal costs. The Court remanded the case back to the Board to decide the merits (*Boeing North Am., Inc. v. Roche, 2002 WL 398756*).

TASK ORDER CONTRACTING

(Editor's Note. We have reported in the GCA REPORT on several GAO and Inspector General reports criticizing the government's use of task order contracting, guidance issued by the Office of Federal Procurement and other agencies and some recent cases. So we were glad when we found a recent article addressing the current general provisions of task order contracting that addresses these recent developments in the June 2001 Briefing Papers written by Raymond Fioravanti of the law firm of Epstein Becker and Green, P.C. and have included recent developments that have appeared after the Briefing Papers article was published.)

Basics

Since Congress in the Federal Acquisition Streamlining Act (FASA) of 1994 explicitly authorized federal agencies to make multiple awards of task and delivery order contracts such contract vehicles have gained in popularity and scope. This contract vehicle allows an agency to award a contract to many and even all offerors competing under a single solicitation. The contracts themselves offer contractors only an opportunity to compete against each other for task orders for services or delivery orders for supplies under the contract (we will collectively refer to the orders as task orders or TOs). The competition for these orders are often conducted informally with little oversight or accountability. The frequency and scope of multiple task order contracting for services was increased even further since Congress passed the Clinger-Cohen Act of 1996 that introduced the Government-wide agency contracts (GWACs) that allow any federal agency to acquire information technology services through the awarding agencies. These changes were widely praised as breakthrough innovations that would streamline the unwieldy procurement process.

FASA defines a task order contract as a contract "for services that does not procure or specify a firm quantity of services (other than a minimum or maximum quantity) and that provides for the issuance of orders for the performance of tasks during the period of the contracts." FAR Part 16.5 is the regulation implementing the FASA directive where task and delivery order contracts are the preferred contract vehicle for federal agencies. Generally, the FAR provision on indefinite delivery/indefinite quantity (i.e. task and delivery order contracts) contracts instruct contracting officers, to the "maximum extent possible", to give preference to ID/IQ contracts under a single solicitation for the same or similar supplies and services to two or more sources. The FAR requires task order contracts for "advisory and assistance services" that include management and professional support services for providing studies, analysis, evaluation, engineering or technical services if they will exceed $10 million (including options) and three years.

The regulations provide little opportunity to protest either the award or individual task orders. The FAR allows agencies to reduce the number of contracts to an "efficient" number where there is no limit to the number of awards. Statements of work may be broad enough to permit a wide range of services and supplies to be procured through individual orders.

Soliciting and Awarding the ID/IQ Contract

Whether it is for an agency or the broader GWACs, the purpose of the award is to have contractors compete with each other through the contract process. This is achieved through two steps: First, an umbrella task order contract is awarded where there is no limitation in the number of awardees that may be selected. Secondly, is the issuance of solicitations for individual task orders where the individual orders may be made on an informal basis using "streamlined" selection processes. Several issues arise:

Umbrella Statement of Work. The initial statement of work in the basic contract is intended to be fairly broad where it provides a definition of the work to be performed in which each order must fall. If a subsequent task order does not fit, it must be processed through another contract. Both FASA and FAR 16.5 provide for broad – some say even vague – statements of work. The limits on how broad a statement can be has not been reached. For example, a recent GWAC for the Federal Aviation Administration contracted a statement of work that included every possible service associated with information technology. Guidance by the Office of Federal Procurement Policy in its "Best Practices for Multiple Award Task and Delivery Order Contracting" states agencies should have flexible broad statements. And one of the only areas of successful protest of task orders is when it exceeds the original scope of work. The OFPP guidelines encourage COs, program managers and industry to work together to develop a clear statement of work.

Bundling. "Bundling" is the practice of consolidating two or more previously smaller contracts into a single, larger contract. The advantages of economies of scale, reduced administrative costs and increased reliability is offset by limiting competition to fewer contractors capable of meeting a broad range of demands which is especially harmful to small contractors. Agencies are instructed to conduct market research and carefully identify the benefits before bundling contracts.

Number of Awardees. Agencies have wide discretion in determining the number of awards it will make under the umbrella solicitation. The FAR instructs COs to avoid situations where particular awardees specialize in one or a few areas of the statement of work that will result in award of task orders to those firms on a virtual sole-source basis. The OFPP

recommends an agency make a reasonable number of awards to ensure competition but that keeps the ordering process from becoming burdensome.

Competitive Range Determination. Selection of ID/IQ awardees receive less scrutiny than single award selection decisions. The FAR allows the agency to reduce the competitive range of offers to an "efficient" number where the agency has broad discretion in setting the competitive range and delivering what is an efficient number. If an agency, for example, decides that of 150 offerors, the competitive range will be set at 40, it may then decide to make awards to all 40 offerors.

Evaluation Factors. Multiple award contracts are subject to the same evaluation requirement as other negotiated procurements. Agencies must consider price (or cost) along with quality. Quality may be measured on the basis of an offeror's past performance record where in a procurement over $100,000 past performance *must* be considered.

Issuing Orders

Competition for task orders begins only after the umbrella contract is in place. After that, contract awardees are entitled only to minimum quantities specified in their contract and a CO may select awardees for task orders using "streamlined" procedures.

Task Order Statement of Work. Unlike the umbrella contract, TO SOWs must be fairly detailed, all orders must be within the scope of the umbrella contract (again, this is the only grounds to protest a specific TO) and orders must include, at least, descriptions of services or supplies, quantity and unit or estimated price.

Streamlined Selection Process. COs have broad discretion in determining the process for selecting recipients for individual TOs and the FAR encourages "streamlined" approaches. The procedures and selection criteria must be identified in the umbrella contract. "Full and open competition" is not required but rather a "fair opportunity to be considered" for each order over $2,500 unless a sole source award is justified. Essentially, the CO can contact two or more contractors and ask them to compete.

The FAR directs COs to keep the requirements for submission to a minimum. Though written proposals may be required, the FAR allows and the OFPP encourages oral presentations. For selection criteria, the FAR requires only price or cost to be considered but adds the CO should consider (1) past performance on earlier orders under the contract (e.g. quality, timeliness and cost control) (2) potential impact on other orders placed with the contractor and (3) minimum order requirements. The OFPP recommends past performance be used as an "initial screen" to determine which offerors will be considered.

In practice, competition is often no more than a formality. Umbrella contract awardees are not required to be notified of an order opportunity. Many may be eliminated from further consideration (i.e. competitive range) because they did not pass the "initial screen". Under GWACs, ordinary agencies may state a preference for a contractor and request they receive a solicitation for an order.

Sole Source Orders. Compared to strict impediments to sole sourcing under normal contracting (e.g. approval by head of contracting agency, protests by others), an agency has significant discretion to award TOs on a sole source basis. Though the FAR directs COs to avoid situations where awardees specialize in only one or a few areas to avoid likelihood of sole-source awards, sole source awards over $2,500 are allowed when (1) the agency's needs are urgent (2) only one awardee is capable of providing the quantity of service because it is unique or highly specialized (3) a follow on contract is justified for reasons of economy and efficiency as long as the original TO was fairly competed and (4) a minimum quantity must be met.

Pricing Orders. The FAR specifies that TO contracts can provide for a wide range of cost or pricing arrangements including cost-reimbursement, time and material, labor hour/level of effort and fixed price. If the task can be specified in sufficient detail to permit reasonable estimates and fair price competition, fixed prices should be used; if not, then other pricing methods may be used. When the umbrella contract does not establish an overall price, the CO is to establish prices for individual TOs using methods established in FAR 15.4 for pricing negotiated contracts.

Contractors' Obligation to Compete. Depending on terms of the umbrella contract, contractors are obligated to submit a good faith proposal if the agency requests one. Otherwise, the agency may simply issue the order at a price found to be reasonable. The OFPP encourages agencies to minimize the requirement for

contractors to submit bids to provide them the flexibility to determine when to prepare bids.

Use of Blanket Purchase Agreements (BPAs). Further circumstances to lessen competition even more is use of BPAs. The FAR defines a BPA as a means of filling anticipated repetitive needs for supplies and services by establishing a "charge account" with qualified sources. BPAs are an acceptable contracting method under the FAR 15 simplified acquisition procedures for purchases under $100,000. The FAR and most recently the General Accounting Office allows agencies to establish BLAs with Federal Supply Schedule (FSS) suppliers where the FSS program gives established ID/IQ contracts with commercial firms to allow agencies to buy supplies and services at stated prices and time periods.

Duration of Contract. Whereas ordinary contracts contain specific dates by which the work must be completed, TO contracts specify a "period of performance" where orders may be placed but not a term of performance under the orders. The only time limit applies to advisory and assistance services where a 5 year time limit applies to placing orders (though not for performance of those orders).

Implications for Contractors

The authors identify some lessons for contractors:

1. Awardees of umbrella contracts will need to actively market their supplies and services to agency officials more. Since officials may specify preferred vendors and follow-on orders may be sole source more marketing activity is called for to take advantage of COs buying discretion.

2. You cannot protest awards of individual TOs except on grounds they exceed the scope, period or maximum value of the contract.

3. When placing individual TOs, the agency is not required to notify you of an opportunity so intelligence gathering become more important.

4. Become very familiar with the TO selection procedures and evaluation criteria set in the umbrella contract. Also, develop skills in oral presentations to meet agencies' desires to streamline procurement procedures.

5. Be aware that agencies may use past performance as an "initial screening" device to eliminate you from further consideration.

6. The umbrella contract may require you to submit a proposal for TOs or, at least, indicate why you are not submitting an offer.

Recent Developments

Some recent developments have been calling into question some of the very practices that were hailed as breakthroughs to streamlining procurements. First, DOD's Inspector General Office recently released a report revealing that of 423 multiple award task orders awarded in 2000 and 2001 it reviewed, 72 percent were awarded on a sole source or direct-source basis. The DOD IG concluded their study demonstrated the government was loosing the benefits of price competition. The NASA Inspector General office released a similar report at the same time concluding "NASA had not received the benefits of competitive bids and may have paid more for goods and services than necessary." Numerous congressional representatives jumped on the reports and expressed critical concern about the lack of competition under task order awards and called for action.

Last April 1, the Department of Defense proposed amending the Defense Federal Acquisition Regulation Supplement (DFARS) to require competition in the purchase of services under multiple award contracts. The proposed rule would require that each order for services exceeding $100,000 be made on a competitive basis requiring (1) the CO provide "fair notice of intent to make a purchase to all contractors offering such services under an umbrella contract and (2) affording all contractors responding to the notice a fair opportunity to submit an offer and have that offer fairly considered. The CO may waive the requirement if one of the four circumstances in FAR 16.505)b)(2) apply (i.e. urgent need, one source of supply, logical follow-on to a preexisting order or sole source required by statute).

An avalanche of commentaries have flowed in response to this proposal. For example, John Chierichella and his colleagues at Fried, Frank, Harris, Shriver and Jacobson assert in the Spring 2002 issue of the Lyman Report that recent efforts to increase competition under Multiple Award Service (MAS) contracts may be "tossing out the baby with the bathwater." They indicate that recent studies by DOD and NASA confirm that competition under MAS contracts are eroding competition which, if allowed to continue, will likely impair the procurement process, make procurement unpredictable and put at risk the very streamlining objectives the MAS contracts were intended to implement. They conclude, however, the DOD proposed requirement of notifying large numbers of contractors and the practicality of evaluating the resulting large number of offers

undermines the original motivation to create MAS and may inhibit future proposals to streamline the procurement process.

IMPORTANT PROCUREMENT DECISIONS LAST YEAR

(Editor's Note. Since the practical meaning of most regulations are what appeals boards, courts and the Comptroller General say they are, we wanted to summarize some of the significant decisions last year affecting successful grounds for protests, past performance information, claims for equitable adjustments, terminations and selected cost issues. We find a review of recent cases lets us know what practices are worth appealing to higher levels and we also find they illustrate interesting pricing and contracting strategies that we never thought of using. This article is based on the January 2002 issue of Briefing Papers written by Miki Shager, Counsel to the Department of Agriculture Board of Contract Appeals and Marshall Doke of the law firm of Gardere Wynne Sewell L.L.P. We have referenced the cases in the event our readers want to study the cases.)

Protests

Timeliness. Under the GAO's Bid Protest Regulations, protests not based upon alleged solicitation improprieties must be filed not later than 10 days after the basis for protest is known and the 10 day limit applies also to raising new and independent protest issues. (*Oceaneering Int'l, Inc., Comp. Gen. Dec. B-287325. Unless otherwise specified all protest decisions are Comptroller General decisions and we will abbreviate the reference by alluding only to the case number*). The 10 day limit applies also to notification of a denial of an administrative appeal (*Crown Support Servs. B-287070*). For challenging the terms of a solicitation, the protest must be filed before bid opening (*J&H Reinforcing & Structural Steel Erectors, Inc. v. US*)

Negotiated Procurements. The GAO made clear that in technical *evaluations* of proposals, they will not reevaluate proposals but will rather examine the record to determine if the evaluation was reasonable and consistent with the stated criteria and applicable statutes and regulations (*Daniel Tech. Inc. B-288853*). In considering the merits of how an agency evaluated a proposal, the GAO looks to *documentation* prepared during the evaluation process. In *Checchi & Co. Consulting Inc. B-285777* the GAO sustained a protest because the agency failed to comply with the FAR 15.102(a) requirement to maintain a record of oral presentations and therefore had no evidence to defend its elimination of the protester. Generally FAR 15.203(a) gives the government a variety of evaluation tools to use where the RFP must describe the factors and significant subfactors to be used to evaluate the proposal and their relative importance. However, an agency need not disclose its evaluation guidelines provided it uses a rational method that is consistent with stated evaluation criteria (*Brown & Root, Inc. & Perini Corp. Joint Venture B-270505.2*). Cost or price must be considered in evaluation of competing proposals (*Beacon Auto Parts B-287483*) when only technical criteria was considered. Also, the GAO sustained a protest of a fixed price incentive contract where the agency failed to properly assess the realism of an awardee's lowest proposed target price (*Ernest Support Svcs. B-285813.3*).

Competitive Prejudice. The GAO will not sustain a protest unless the protester can show it had a substantial chance of winning the award (*McRae Indu. Inc. B-287609.2*). The GAO found prejudice (i.e. harm) for protesters where the FAA improperly relaxed a solicitation requirement for the awardee and the record showed they could have proposed a different system had they been notified of the agency's critical needs (*Systems Mgmt., Inc. B-287032.3*). In another case, the Court ruled a protester must show both (1) there was a significant error in the procurement process and (2) the error competitively prejudiced the protester where they must show there was a "reasonable likelihood" they would have won the contract but for the error (*Information Tech & Applications Corp. v. US*). A protester failed to satisfy these requirements in *Maintenance Engrs v. US* where even after making adjustments for the error it would have received two "Very good" ratings compared to two "exceptional" ratings given to the awardee where the Court ruled prejudice wasn't shown where the protester did not demonstrate a "substantial chance" of winning the award.

Miscellaneous Issues

1. *Best value criteria was not adequately considered.* Protests were sustained when (a) technical evaluation on a fail/pass basis was made where the solicitation said award would be made on a technical/price tradeoff (*Special Operations Group B-207013*) (b) Agency fails to consider whether awardee's technically superior proposal was worth the price (*Beacon Auto Parts B-287483*) and (c) agency failed to consider protestor's lower price (*A&D Fire Protection, Inc. B-288852*).

2. *Small business participation*. Where evaluation was based on small business participation, not small business subcontracting, it was improper to reject a small business's proposal and evaluate only its subcontracting to small business without considering whether the offeror itself was a small business (*Summit Research Corp. B-287523*).

3. *Discussions*. FAR 15.306(d) requires COs to discuss with each offeror being considered for award significant weaknesses, deficiencies and other aspects of its proposal that could be altered or explained to enhance the potential for award. *World Travel Services v. US* established there is no requirement that all areas of a proposal having a competitive impact be addressed during discussions but only significant weaknesses i.e. those that appreciably increase risk of unsuccessful contract performance. Also, agencies are not required to "spoon-feed" an offeror each item needing to be addressed but only to lead offerors into areas of deficiencies needing amplification (*KIRA Inc. B-287573*). However, it was unreasonable to reject an offeror's proposal without discussion because it did not show specific required experience (*SWR Inc. B-286161.2*).

4. *Below cost bids*. When the offeror offered to provide commercial travel office services at not cost to the government and inserted "$zero" in its proposal, the GAO confirmed there was no prohibition of offering a below-cost bid for a fixed price contract (though it can be argued the contractor cannot perform, which affects its responsibility status) (*Sato Travel B-287655*).

Past Performance

Past performance information (PPI) is a critical evaluation factor that must be considered in all negotiated procurements and is often a key factor on other procurements.

Requirements for considering PPI. FAR 15.306(b) provides that when discussions in negotiated procurements are conducted, offerors *must* be given the opportunity to clarify adverse PPI while awards without discussions, FAR 15.306(a) merely provides that offerors *may* be given the opportunity to clarify. In *Digital Sys. Group, Inc. (B-286931*) the protester argued the agency did not allow it to comment on two marginally rated items in one of its references and the GAO ruled that FAR 15.306(d) only requires agencies to obtain comments on PPI that could be altered or explained to enhance materially the chances for award. The GAO concluded the FAR does not require offerors have the opportunity to comment on each less than perfect rating where, in this case, the marginal ratings were neither significant weaknesses nor deficiencies and hence could not have been altered to materially enhance chances for award. Also, in *Maytag Aircraft Corp B-287589* the GAO ruled it was reasonable not to conduct discussions where issues were mostly factual and the source selection committee had first hand knowledge of the facts resulting in no harm where discussions would not materially enhance the proposal.

Methods of Evaluating PPI. Where the protester asserted certain subfactors considered under other evaluation factors were redundant of past performance factors resulting in an exaggeration of importance of PPI, the GAO denied the protest holding there was no limitation on how much weight an agency can give a particular evaluation factor (*American Med. Info. Servs., Ind B0288627*). In *OSI Collection Servs., Inc. B-286597.2*, the GAO found the agency performed an "overly mechanical" comparison by reducing the PPI of a contractor to a single score rather than using a "reasoned judgement of evaluators in examining and comparing the actual past performance of offerors." The protester argued its prior experience in building a missile facility entitled it to a credit for a golf course clubhouse construction contract and the GAO ruled though it was true the missile facility was more complex, an agency is not required to give evaluation credit for features it determines will not contribute to its needs (*Five-R B-288190*). Similarly in *Oceaneering Int'l B-287325*, where the protester argued its more complex past contracts should be considered more relevant, the GAO ruled the agency properly disregarded the credit because the RFP did not identify any discriminators the protester said warranted considering its past performance history favorably and hence the agency's evaluation was reasonable and consistent with the RFP. The GAO also found it was correct to treat similar PPI differently where the awardee was "cooperative when problems arose" while the protester was not (*Ready Transp. Inc. B-285283.3*).

Evaluation of Subcontractors' PPI. Based on the awardees intent to rely more heavily on their subcontractors than the protester intended, the GAO ruled the agency properly treated the two offerors differently in crediting them for the past performance of their subcontractor (*Strategic Resources Inc. B-287398*). In the same protest, the GAO ruled the agency properly disregarded its subcontractor and heavily weighted

its current contract because the subcontractor was to provide only 20% of the contract effort and its current contract was a better indicator of future performance. In *Kira Inc. B-287577*, the GAO ruled it was not unreasonable to consider a subcontractor's performance when they were expected to perform a major portion of the work and the subcontractor's performance history was a reasonable indicator of performance. In a protest of an 8(a) award, the GAO held the agency properly evaluated the PPI of a non-small business subcontractor when the RFP permits use of subcontractors unless consideration of PPI is prohibited by the solicitation (*Myers Investigative & Sec. Servs. Inc. B-286971*). Also, in *Goode Constr. Inc. B-288655*, the GAO ruled it was proper to consider the performance history of large business subcontractors in a HUBZone set-aside where neither of the two offerors had any relevant past performance. It was also appropriate to consider the lack of relevant experience of a protégé firm in a mentor-protégé program when the protege would be performing the majority of work (*Urban-Meridian Joint Venture B-287168*).

Contrary Solicitation Requirements. The most successful basis for protesting an award is to prove the agency did not follow the RFP in evaluating past performance. *In Myers Investigative & Sec. Servs. B-288469*, the solicitation for guard services stated all of offerors' current contracts and similar sized ones in the previous five years would be evaluated where the GAO found the information "played no discernible role in the selection decision" which was based merely on the offerors' performance for the agency only.

Role of Key Personnel for PPI. The GAO held that the protester was entitled to past performance credit for experience of key personnel during their former employment with the awardee while at the same time the awardee could receive past performance credit for the projects managed by the former key employees (*MCR Engrg Co. B-287164*). Similarly in *General Atomics B-287348*, the GAO ruled it was reasonable to attribute past performance credit for key personnel working for the awardee when they previously worked for the protester. It was also found reasonable to credit principles' experience under the key personnel factor but not also to attribute that same experience to a newly formed firm as a whole under the corporate experience factor *(Blue Rock Structures B-287960*).

Claims and Terminations

What constitutes changes. A *constructive change* to a contract occurs when requirements are changed without a formal "order" to do so (either an informal order, direction or by the fault of the government). The Appeals Court in *Taratoros v. General Svcs. Admin. GSBCA 15083* ruled that a directive by the government to install sprinklers in the attic of a building was a constructive change, finding the contract did not require it. Sometimes a contract may be *accelerated* by certain directives or constructive orders. A maintenance service contractor claimed it was entitled to extra cost because the government constructively accelerated performance by directing it to complete all work to clear brush from a stream channel by the end of the fiscal year. The board rejected its claim stating it was able to complete the contracted work before the end of the year citing the fact it was seeking more work during the period (*SAWADI Corp. ASBCA 53073*).

Unabsorbed overhead. Though the Board agreed the government unreasonably suspended work of renovating 24 housing units by failing to release the last 12 units, it denied the contractor's claim for unabsorbed overhead on the grounds the contractor was never on standby because it performed half the work on the first 12 units during the suspension period *(Carousel Dev. Inc., ASBCA 50719)*. The Board agreed the contractor was entitled to Eichleay overhead even though the delay had not caused the contractor to wholly suspend all work since the Eichleay formula criteria was met because the contractor's work was significantly interrupted (*Roy McGinnis & Co. ASBCA 49867*).

Delay in meeting schedules. In evaluating a contractor's claim that government action prevented it from a planned early completion, the board asserted the contractor could not demonstrate the admitted government problems caused the delay because it never submitted a revised schedule for early completion that could be compared to actual work (*Kaco Contracting Co. ASBCA 44937*). The Court determined a total time approach attributing all the difference between the original and actual completion dates to the government caused delays was "of virtually no value" in meeting the contractor's burden of proof because it mistakenly assumes the government is responsible for all delays (*Morganit Nat'l, Inc. v. US*).

Equitable Adjustments. The contractor, not the government, has the burden of proving the amount by which the change increased its cost of performing the contract (*Sauer Inc. ASBCA 39605*). The risk of increased costs from differing site conditions usually falls on the government while bad weather does not. When the contractor claimed "rolling waves" constituted a differing site condition entitling it to an equitable adjustment under the "Differing Site Conditions" clause the board found the waves were caused by bad weather not unknown physical conditions entitling it not to an equitable adjustment but to a time extension for delays caused by unusual severe weather (*Luke Bros. Inc. ASBCA 52887*). A significant change in inspection procedures can lead to increased costs where a subcontractor was entitled to an equitable adjustment where systematic changes in inspection procedures unreasonably disrupted its performance (*Grumman Aerospace Corp. ASBCA 50090*). Also, the board held a contractor who paid out unused sick leave in its first year option period under a new collective bargaining agreement (CBA) for accrued costs in its base year was entitled to an equitable adjustment because the base year contract was covered by a different CBA (*Penn Enters., Inc. ASBCA 52234*).

Termination for convenience (T for C). The Board held the government's failure to order the minimum estimated quantity under an ID/IQ contract should not be considered a T for C and should not be limited to lost profit on the unordered quantity. Rather, the contractor was entitled to be paid the difference between contract revenues and minimum guaranteed payment where the contractor was required to maintain capability up to the maximum level of service (*Mid Eastern Indus. Inc. ASBCA 53016*). The equitable adjustment arising out of a partial termination is for the increased cost of continued work due to the partial termination, not for claimed increased costs that would have been increased in the absence of the termination (*Aeronica Inc. ASBCA 51927*).

Termination settlement costs. In determining whether a termination settlement proposal is a claim (which disallows preparation costs) or contract administration (which allows such costs), the Board stated it is now well established that a contractor's settlement proposal does not "ripen" into a claim until the parties have reached an "impasse", creasing a dispute (*Voices R Us, Inc. ASBCA 51565*). In *General Dynamics (ASBCA 52283*), a subcontractor purchased special tooling and test equipment (STE) for its subcontract and when it was terminated the price and subcontract settled the $2.5 million of unamortized costs for $500,000. The government refused to reimburse the prime contractor but the Board ruled its was entitled to it because (1) the parties have the discretion under a T for C to reconcile basic fairness with strict application of accounting principles (*Codex Corp. v. US*) (2) recovery for loss of useful value of STE is not limited to the amount included in the price (*American Elec. ASBCA 16635*) and (3) the settlement was less than the amount the subcontractor would be entitled to under litigation. A contractor has no reasonable expectation to recover continuing home office overhead expenses under a termination but it may recover standby or idle equipment costs following a termination (*Walsky Constr. Co. ASBCA 52772*).

Claim Requirements. Though contractor expressed the intention to submit an invoice at a later date for unabsorbed overhead, it submitted several invoices when work was complete and the government rejected them asserting the invoices did not meet the requirement for a claim to request a "sum certain" amount. The board ruled the fact a contractor has not completed all work under a contract mod or change does not mean it is prohibited from submitting one or more claims for portions of work that have been completed (*MDP Constr. Inc. ASBCA 52769*). The Board ruled a claim stating damages were "in excess of $5,000,000" is not a valid claim because claims for "in excess of" a specified amount does not satisfy the requirement for a "sum certain" (*Goodwin Equip. Inc. ASBCA 53462*). Proper certification is required only for claims exceeding $100,000. The board ruled that individual claims under $100,000 where the total of all claims exceeded $100,000 do not meet the threshold requirement and hence do not require certification (Velia Flying House v. US).

Costs

Miscellaneous costs. The government refused reimbursement to a prime contractor for payment of its cost type subcontract for insufficient documentation of costs while the prime contractor asserted (1) the subcontractor completed its assigned work (2) the government did not question the subcontractor's costs and (3) it actually paid the invoiced amounts. The Board held the prime contractor could not recover the subcontract costs because of insufficient cost documentation where affidavits, prime contractor audits or other probative cost records to support the costs incurred by the subcontractor were absent (*Analytical Assessments Corp.*

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ASBCA 52393). Where assets purchased were converted from dollars to turkish lira using the exchange rate in effect at the time of investment and the subsequent depreciation costs were claimed using the exchange rate in effect at the time of computing the annual depreciation costs, the Board ruled both FAR and CAS were silent on the matter and held FASB 52 "Foreign Currency Translation" requires use of historical exchange rates be used in determining depreciation costs (*General Elec. Co. v. Delaney*). The contractor incurred costs in connection with an expected RFP and charged them as "other indirect technical effort" covered by FAR 31.205-12, "long range planning and FAR 31.205-38, "selling costs" while the government asserted they were unallowable bid and proposal costs under FAR 205-18. The board did not rule on the costs but, instead, said the proper cost principle would be a factual question determined by the "principal primary purpose" for incurring the costs (*TRW Inc. ASBCA 51172*). The Board held that business entities under "collaboration agreements" where parties share benefits, investments and activities are not "subcontractors" and hence revenue share payments are not subcontract costs requiring inclusion in the indirect allocation bases (*United Techs. Corp., Pratt & Whitney, ASBCA 47416*).

State Income taxes. In *Information Sys. & Network Corp. v. US* the Court ruled the state tax paid by the sole shareholder of the contractor, a Subchapter S corporation, was an allowable and reimbursable cost of the company, rejecting the governments assertion it was unallowable since Subchapter S corporations had no tax liability. In *Hercules, Inc. v. US* the contractor received a refund in 1995 for a state income tax paid and claimed as a 1987 contract cost. In calculating the government's share of the refund, the Court said the contractor should use the ratio of apportionment factors in effect in 1987 rather than 1995 since the refund is a reduction of a 1987 contract cost.

Limitation of Costs. Under a special plan applicable to defense contractors, contractors paid and recovered an insurance "deposit premium" annually where the true premium price would be established at the end of the plan. When the final settlement was established and the contractor sought to charge its cost type contract for the additional premium, the government rejected it on the grounds it exceeded the "Limitation of Cost" clause of the relevant contract. The Court held the government liable for the amount claimed because (1) the final premium was not reasonably foreseeable (2) the contractor could not avoid the escalated premium cost and (3) the CO decided to fund the overrun. The Court stated any of the three reasons stated above would be sufficient to compel the government to reimburse costs (*Johnson Controls World Servs. V. US*).

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