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RECENT CHANGES TO TIME & MATERIAL LABOR HOUR CONTRACTS

(Editor's Note. Treatment of non-employee labor on time and material contracts is a long standing controversy. We recently reported briefly in the GCA REPORT on some significant changes to the rules. Following numerous inquiries we decided to provide a more detailed account of the changes. We have used our own careful reading of the changes as well as an analysis of the changes in an article written by XXX in the YYY issue of the Federal Contracts Report.)

Effective Feb. 12, 2007 contractors providing services to the federal government under time and materials (T&M) or labor hour (LH) contracts are facing a new set of rules that will affect the way they price, cost and manage their contracts. These new rules, which take the form of revisions to FAR and DFARS including six new or revised contract clauses, take different forms depending on whether the T&M contracts are for commercial or noncommercial items, whether the contract is a result of adequate price competition or not and whether the purchases are for the Defense Department or another agency.

Background

T&M (unless otherwise specified T&M apply equally to LH contracts) contracts permit the government to acquire service on the basis of direct labor hours at specified hourly rates. In addition to actual employee pay rates, the fixed hourly rates include contractor overhead, G&A and profit. Materials provided in conjunction with labor hours are typically provided to the government at the prime contractor's cost. In contrast to fixed price contracts, the government's price will largely be based on the number of labor hours provided by the contractor and in contrast to cost reimbursement types of contracts, the labor charges are not limited to the contractor's actual costs.

Because the government views T&M contracts as providing less incentive for efficient performance than fixed price contracts the FAR provides they should be used only when the scope of work or duration of performance is not defined sufficiently to allow a reasonable basis for a fixed price contract. In recent times there has been confusion over whether prime contractors could include profit in the labor rates they charged the government for subcontract labor. In guidance issued April 9, 2004 the Defense Contract Audit Agency stated it interpreted the T&M payment clause at FAR 52.232-7 as limiting the price prime contractors could charge, treating subcontract labor as essentially a pass-through cost, meaning the prime contractor could not include any profit or other added margin to the price charged to the government as subcontract labor. DCAA's interpretation conflicted with the prevailing practice under which parties applied the clause's limitation only to subcontracts for materials, not for labor. DCAA's position was widely criticized as unfair because prime contractors would not be able to recoup costs incurred for administering subcontract labor or for the risk assumed for defective subcontractor work.

The rulemaking process started in Sept. 2004 when the FAR Council issued a proposal that would have required prime contractors to treat subcontract labor as a pass-though cost. A year later, the Council issued separate proposed FAR rules: one covering T&M contracts for commercial services and one for non-commercial services. Both proposed rules adopted a default approach where subcontract labor hours would be treated as "materials" and charged to the government at the prime contractor's cost. Two years of discussions, fact finding and public meetings ultimately led to, on Dec. 12, 2006, three sets of regulations governing T&M contracts: (1) a final FAR rule that applies to commercial item acquisitions (2) a final FAR rule applying to noncommercial item acquisitions and (3) an interim DFARS rule applying to DOD noncommercial item acquisitions.

FAR Commercial T&M Rule

Though initially limited to only certain services (e.g. ancillary services in support of a commercial supply item) the government decided the designation "commercial" should apply to any service that is of a type commonly sold to the general public on a T&M basis. Rather than limit applicability to a type of service, use of T&M contracts were to be used only in circumstances where requirements were not sufficiently understood to complete a well-defined

scope of work needed for a fixed price contract. The FAR imposes significant requirements before an agency can use a T&M contract.

For commercial T&M contracts, the final rule permits prime contractors to request payment for subcontract labor (including third party subcontractors and interdivisional transfers) at the hourly rates prescribed in the contract for those employees that satisfy the contract's applicable labor category qualifications. These hourly rates may be a singe set of labor rates that do not distinguish between work performed by prime contractor or subcontractor employees. A new solicitation clause FAR 52.216-31 requires the prime contract to identify the categories to which the hourly rates apply including (1) the offeror (2) its subcontractor and/or (3) divisions, subsidiaries or affiliates of the prime contractor. Another new clause at 52.212-4 (Alt 1) provides that services not corresponding with the labor categories in the prime contract will generally be considered to be "incidental services" and are reimbursed as "materials" (discussed below). The FAR Council rejected the earlier approach that would have limited government payment for subcontract labor to the prime contractor's cost unless the subcontractor was pre-approved by the CO. After receiving numerous comments, the Council concluded such a practice was contrary to commercial practices, would discourage prime contractors to use subcontractors which are primarily small businesses and would impose government-unique cost accounting requirements on interdivisional transfers.

FAR Noncommercial T&M Rule

The final rule abandons the early proposed rule that would have allowed reimbursement for subcontract labor at hourly rates only if the subcontractor was listed in the contract. It introduces two new FAR clauses concerning listing hourly labor rates and prescribes use of one or the other depending on whether the CO determines the price to be based on adequate competition. These clauses apply to civilian agencies while there is an alternative clause to apply to DOD acquisitions when price competition is expected.

When Adequate Price Competition is Expected. When price competition is expected, all labor hours satisfying labor categories in the prime contract must be paid at the hourly rates specified in the prime contract. This approach is the same one adopted for commercial items, basically reasoning that competition is competition, whether for commercial or noncommercial items. A new FAR clause 52.216-29 requires the offeror to specify whether each of the hourly rates apply to labor performed by the offeror, subcontractors or affiliates of the company. It instructs offerors to establish the hourly rates using one of the following methodologies: (1) separate rates for each labor category by the offer and each subcontractor and affiliate (2) blended rates for each labor category or (3) any combination of separate and blended rates for each labor category. These rates include wages, overhead, G&A and profit. The term "blended" indicates the rate applies to multiple entities and does not necessarily mean the rates must be based on a weighted calculation. The rule allows agencies the discretion to develop procedures that authorize COs to make one of the three methodologies mandatory where as we will see below, DOD has already done so.

When Adequate Price Competition is Not Expected. When price competition is not expected, the rule prescribes a different new FAR clause at 52.216-30 be used. This clause requires offerors to list separate sets of hourly rates for each subcontractor and affiliate. Such a different approach is based on the need for a more cautious approach without the safeguard of competition. The prime contractor may still include its profit (in addition to wages, overhead and G&A). The separate rates are intended to provide the CO with additional cost or pricing information along with any information required under the Truth in Negotiations Act to analyze the price reasonableness of the proposal. Another distinction for noncompetitive contracts is that hourly rates for services transferred between affiliates of the offeror may include profit for the prime contractor but not the transferring organization. However, an exception to this rule is if the transferred hourly rate meets the definition of a commercial item in FAR 2.101 in which case the transferred price would be based on established catalog or market rates which presumably do include profit.

DFARS Interim T&M Rule. The DOD rule provides a different approach when adequate price competition is expected by requiring offerors to specify the fixed hourly labor rates for each subcontractor and affiliate. The rule prescribes a separate DOD-unique clause DFARS 252-216-7002(c) which is substituted for the FAR 52.216-29 applicable when price competition is expected. Here, the blended rate approach is not permitted. The rationale for the different approach is the relatively large dollar value of many noncommercial DOD T&M contracts, recent

increased oversight of DOD contracting practices and the preponderance of noncommercial T&M contractors and subcontractors who already possess the necessary abilities to establish separate fixed hourly rates. It should be said the DFARS rule applies only to the requirement to separately list hourly rates for subcontractors and affiliates – it does not preclude the prime contractor from adding its profit to the labor rates designated for each subcontractor.

Materials, Other Direct Costs and Indirect Costs

To fix the problem of prior rules not clearly addressing the treatment of materials, the new rule now says "materials" are direct materials, subcontracts for supplies and incidental services (services for which there is no labor category specified), other direct costs (ODCs) and indirect costs. Materials meeting the definition of commercial items may be reimbursed at the established catalog or market price while materials not meeting this definition will be reimbursed at actual cost.

FAR Commercial T&M Rule. For contractor-furnished direct material and "incidental services" that meet the definition of commercial items in FAR 2.201 the price paid will be the established catalog or market price, adjusted to reflect the quantities being purchased and any modifications required under the contract. The provision does not limit material to those owned by the contractor so third party materials which the prime contractor acts as a reseller may also apply. If the direct materials or incidental services do not meet the commercial item definition the price to be paid is the cost to the prime contractor - i.e. it does not include profit or G&A. Even though reimbursed at "cost", those items under the commercial T&M rule are not subject to the FAR Part 31 cost principles.

For ODCs such as travel, computer usage charges, etc agencies may reimburse contractors based on cost but only for the types of ODCs designated in the contract. So, ODCs must be identified up front in the contract. For indirect costs not already included in the fixed hourly rates (e.g. material handling costs) agencies may reimburse contractors at a fixed amount allocated on a pro-rata basis set forth in the contract payment schedule. Contractors bear the risk of the indirect costs exceeding the fixed amount negotiated and specified in the contract.

FAR Noncommercial T&M Rule. For contractor-furnished direct materials and incidental services, a revised FAR payments clause allows payments for commercial items *owned* by the contractor to be paid by established catalog or market prices. If not owned, then payment will be at the amount of cost incurred by the contractor subject to FAR cost principles and the Allowable Cost and Payments clause at FAR 52.216-7. The latter clause expressly says the government does not pay profit or fee on materials except for the commercial item exception – contractor may recover such fees through their fixed hourly labor rates. For ODCs and indirect costs, the contractor may include such allocable costs (e.g. handling rates) to the extent they are comprised only of costs that are clearly excluded from the hourly rate and allocated in accordance with the contractor's established accounting practices. Indirect costs may not be applied to subcontract labor that is paid at the hourly rates.

GRANT THORTON SURVEY ON PROFESSIONAL FIRMS

(Editor's Note. With the cessation of the Wind2 survey we summarized each year we were very happy to find Grant Thorton's "12th Annual Government Contractor Industry Survey 2006." It benchmarked primarily similar professional services firms that Wind2 followed but offers, in our opinion, even more relevant information. Grant Thornton – you know the firm whose advertisement says they have a "passion for accounting" – provides consulting services to government contractors. You can contact the firm at 703-847-7515 to purchase a copy of the survey.)

♦ Company Profile

83% of the "over 100" surveyed firms are privately owned, 12% are publicly traded and 5% are not-for-profit concerns. 56% are small businesses while 44% are large. 17% are minority-owned while 12% are women owned. More than 92% of respondents are service companies while 8% sell products. The services companies consisted of engineering (23%), information technology (20%), support services (17%), consulting (15%) research (15%) and training (2%). The primary customer of the respondents is the federal government where 88% of the revenue comes from the federal government. 56% of their revenue came from the Defense Department, 32% from other federal agencies while 6% came from state and local government and 6% was commercial. 53% of respondents had increased revenue over the prior year, 25% had no significant change while 22% had reductions. 13.6% of total headcount represented indirect labor with the following breakdown of

functions: finance and accounting (2.5%), human resources (1.4%), IT support (2.4%), contract administration (1.3%), legal (.8%), pricing (.5%), procurement (.9%), sales and marketing (1.9%), corporate officers (1.3%) and office maintenance (.8%).

♦ Cost Structure

Fringe Benefit Rates. Fringe benefit pools consist of payroll taxes, paid time off, health benefits and retirement benefits (some include bonuses while others do not). Fringe benefit rates as a percentage of total labor averaged 38% when bonuses were included and 32% when excluded.

Overhead Rates. These costs are considered to be in support of direct staff working directly on contracts and hence are normally allocated as a percentage of direct labor costs. Some companies include fringe benefits associated with direct labor in the direct labor base while others do not – the result when they do is to lower overhead rates. Average overhead rates are as follows: (a) on-site direct labor -70% (on-site means performed at company sites) (b) on site direct labor and fringes – 49% (c) off-site direct labor – 38% (off-site is lower because facility related costs are normally borne by the customer at their facilities) and (d) off-site direct labor and fringes – 22%. When companies used multiple overhead rates logic used for them were location (51%), market (15%), labor function (14%), customer (14%) and products versus services (6%).

G&A Rates. The survey states that general and administrative rates are typically those incurred at the headquarters and include executives, accounting and finance, legal, contract administration, human resources and sales and marketing. (*Editor's Note. In our experience, the elements of costs included in G&A pools vary more than the survey implies. G&A costs may include non-overhead indirect costs incurred at a business segment level which usually includes an allocation of headquarters costs while we also find all the categories of overhead costs identified above as part of the G&A pool when a company decides such categorizations meet their needs.*) G&A costs are most often allocated to contracts based on total cost input (direct operating costs, overhead, material, subcontracts) or value added base that generally includes all the above costs except material and/or subcontracts. Average G&A rates under a total cost input was 11% while those using a value added cost input was 15%.

Material handling and subcontract administration costs. 55% of surveyed companies used a material handling or subcontract administration rate as a burden chargeable on material and subcontract costs (a significant increase over prior periods). Average material handling rate was 3%, subcontract administration rate was 5% and combined was 4%.

Special allocations. The FAR and CAS provide authority to negotiate special allocations of indirect costs when an inequitable allocation would result from its normal practices such as when there is an unusual dollar amount of material, subcontracts or equipment that does not commonly occur on its other work. Only 7% used a special allocation.

Billing practices for rate variances. When there are differences between provisional billing rates and actual rates the government generally requires an adjustment on billings be made on cost type contracts. 37% of respondents said actual rates exceeded their provisional rates while 11 % reported the opposite. The remaining 52% stated there was no significant difference. For those reporting actual rates exceeded provisional rates, 37% of the companies did not collect any of the rate variance, 24% collected the entire variance while the remaining 39% collected a portion. Reasons cited for collecting none or only some of the rate variance were contract funding limitations (40%), customer relations (30%) and contractual rate ceilings (30%). 81% of those collecting rate variances waited for final incurred cost audits, contract closeouts or other formal approvals while 19% billed for rate variances when the annual incurred cost submission was made (*The writers of the survey correctly recommend contractors invoice and collect variances as soon as possible given funding risks since the regulations permit rate variances to be billed when actual rates have been submitted to the government on a timely basis.*)

Service centers. Certain functions that support the company are accumulated in separate pools and then charged to users (e.g. clients, indirect cost pools) on a pre-established allocation method. The most frequently used service centers are facilities (used by 45% of the respondents), information technology (40%) and human resources (25%).

Labor multipliers. Multipliers are fully loaded labor multipliers used to price out work (*see our last issue of the GCA REPORT*). The average labor multiplier was 2.0 for on-site work and 1.7 for off-site work. Almost all respondents expressed a belief their labor multipliers were competitive with their industry.

Uncompensated overtime. (*Editor's Note. We have analyzed this issue in numerous prior issues of the DIGEST – XXX.*

Uncompensated overtime refers to hours worked exceeding the normal 40 hour work week by those salaried employees exempt from the Fair Labor Standards Act.) 70% of respondents said their employees work uncompensated overtime while 30% said no. 63% of the companies use total time reporting while the other 37% report only 40 hours per week. 60% use a rate (or hours) compression method of accounting (e.g. computing an effective hourly rate dividing salary by hours worked) while 40% use a "standard/variance method" that charges an hourly standard rate and then credits an indirect cost pool for the difference between labor costs charged to projects and compensation paid to employees.

♦ Government Contracts

The Defense Contract Audit Agency, because of their Defense Department contracts or contracts with other agencies that use the audit agency, audits most of the contractors in the survey. 87% of respondents described their relationship as excellent or good while 13% described it as fair or poor. (*Editor's Note. That is certainly a surprise to us but understandable since we are often asked to help contractors only after they have a poor experience with auditors. We would be shocked, however, if the same level of satisfaction applied to other agencies' or local and state auditors.*) The most frequent types of costs questioned by DCAA are executive compensation (25% citing this as an audit issue), consultant costs (10%), indirect cost allocations (8%), legal expenses (8%) and bonuses and incentive compensation (8%). Most frequently cited violations of cost accounting standards were CAS 405, Unallowable costs (17% cited this as a compliance issue), CAS 403, Home office expenses (15%) and CAS 410, G&A (15%). 91% of surveyed companies reported that DCAA did not question a significant amount of costs while 9% reported either a significant or very significant amount. Of those companies experiencing audit issues, 35% were very satisfied with the resolution of the issues, 55% were somewhat satisfied and 10% were not satisfied.

♦ Workforce Compensation and Fringe Benefits

The shortage of skilled workers has forced most companies to offer a comprehensive package of incentive compensation and fringe benefits as part of a minimum compensation package to attract needed personnel.

Medical benefits. In response to questions asking what percent of health benefits are paid by the company the survey results were: 11% reported the company pays for less than half, 9% pays 51-60%. 16% pay 61-70%. 29% pay 81-90% and 14% pay 91-100%.

410(k) benefits. On average the company will match an employee's contribution up to 6% of their compensation and 84% of respondents reported they do not anticipate any changes in the near future.

Wages Increases. Surveyed companies state that the average increase was 4.5%.

Paid time off. Companies paid an average of 10 holidays per year. Approximately 49% combine vacation, holiday and sick leave into a single personal time leave package while 47% maintain separate leave benefits for each type of leave.

♦ Executive Compensation

(*Editor's Note. Care should be used if our readers consider substituting the following results for a bona fide compensation survey where hundreds of firms are surveyed. However, the results shown below are interesting.*) Surveyed companies provided information on the four highest paid executives in the company and the results are presented by company size measured by revenue for 25th, median and 75th percentiles. The following is a summary of the results.

Highest Position (in thousands)

Revenue	25%	Med.	75%
$1-10 M	162	257	275
$11-20M	210	275	380
$21-50M	240	400	446
$51-100M	290	425	500
>$100M	440	567	844

Second Highest Position

$1-10 M	150	165	230
$11-20M	197	236	280
$21-50M	200	273	350
$51-100M	220	295	347
>$100M	335	364	417

Third Highest Position

$1-10 M	123	165	200
$11-20M	168	196	270
$21-50M	180	215	285
$51-100M	185	230	347
>$100M	305	331	383

Fourth Highest Position

$1-10 M	118	132	165
$11-20M	160	195	238
$21-50M	163	205	265
$51-100M	174	220	304
>$100M	280	325	374

REVIEW OF PROCUREMENT AND COSTING ISSUES IN 2006

(Editor's Note. Since the practical meaning of most regulations are what appeals boards, courts and the Comptroller General say they are, we are continuing our practice of summarizing some of the significant decisions last year affecting grounds for successful protests of award decisions, grounds and dollar entitlement for claims and terminations and cost and defective pricing issues. This article is based on the January 2007 issue of Briefing Papers written by Miki Shager, Counsel to the Department of Agriculture Board of Contract Appeals. We have referenced the cases in the event our readers want to study the cases.)

Protests of Award Decisions

♦ Interested Party

To have standing to protest a procurement, a protester must be an interested party – an actual or prospective offeror whose direct economic interest would be affected by the award. A protester is not an interested party where the record shows that several other offerors, not the protester, would be in line for award (*GC Services, Comp. Gen. Dec. B-297807. We will refer to Comp. Gen. decisions by the name of the company and the case number*). An offeror who would be eligible to compete on a resolicitation if a protest is sustained is an interested party (*PDS Consultants, B-297890*). A company who could have but chose not to submit a proposal is not an interested party because it had no chance for award (*Rex Service Corp. vs. US 448 F.3d 1305*). A prospective subcontractor is not considered an interested party (*Pure Power! V US 70 Fed. Cl. 739*).

♦ Unbalanced Bids

A bid is unbalanced if it is based on prices significantly less than cost for some work and significantly overstated for other work and there is some reason to doubt the bid will result in the lowest overall cost. An acceptance of a proposal with unbalanced pricing is not, in itself, improper provided the agency has concluded that the pricing does not impose an unacceptable risk and the prices the agency is likely to pay is not unreasonably high (*Tessa Structures, B-298835*). Below-cost pricing is not prohibited and the government cannot withhold an award merely because its low offer is or may be below costs (*Advanced Technology Systems, B-296493*). A below-cost bid is permissible because contract payment will be based on the offered price (*Sealift, Inc. B-298588*). Also the fact that an offer may not include profit or may be an attempted buy-in does not, in itself, render an otherwise responsible firm ineligible for award (*CC Distributors v. US, 69 Fel. Cl. 277*). However, an agency may properly eliminate a bidder if the agency makes a judgment that there is a risk of poor performance if a contractor is forced to provide services at little or no profit under a fixed-price contract (*Outsourcing Services, B-295959*).

♦ Evaluating Negotiated Contract Proposals

The government is free to use a variety of evaluation factors in evaluating proposals. However, the RFP must describe the factors and significant sub-factors to be used to evaluate proposals and their relative importance and agencies must evaluate the proposals according to the criteria established in the solicitation. Agencies must evaluate proposals in accordance with criteria spelled out in the solicitation (*PHT Supply Corp. v US 71 Fed. Cl. 1*) and a protest was sustained where the record showed the agency did not properly evaluate the proposal in accordance with the solicitation's cost realism criterion (*Serco Inc. B-298266*). In 2006 the GAO sustained several protests where the agency's source selection decision was irrational and/or inconsistent with the administrative record. In deciding these protests the GAO generally considered the record at the time of evaluation and gave little weight to hypothetical arguments presented during the protest hearing. For example, a protest was denied where the record showed the agency made a reasonable determination that the technical superiority was worth the additional price (*Publia Engrg of CA, B-297413*).

Agencies must apply *evaluation criteria equally* to all competitors. A protest was sustained that claimed the agency permitted the awardee to propose to perform the contract on a basis different than was required in the contract without allowing other offerors the same opportunity (*Wiltex Inc. B-297444.2*). An award for an operation and maintenance contract was invalidated because the agency's technical evaluation applied a significantly more stringent standard of review to the protester's

proposal and where it had applied reasonable skepticism in evaluating others' proposals the agency had "abandoned this skepticism" (*BAE Systems Technical Svcs, B-296699*).

Agencies must consider *cost or price* in evaluating competing proposals and ruled that a competitive range determination was invalid because price was not properly considered (*Avue Technologies, B-298380.3*). Also the GAO held that under a task order for services the ordering agency must consider the proposed level of effort and mix of labor to determine that the total price is reasonable even if the solicitation does not call for such a determination (*Advances Technology Systems, B-298493.6*).

Cost realism analysis decisions received considerable attention in 2006. In one decision the GAO held the agency's cost realism's upward adjustment of a proposal was unreasonable because it resulted in the awardee being evaluated as having a lower cost than the protester such that no cost/technical analysis was performed (*Kellogg Brown & Root, B-298694*). Where an offeror intended to team the agency must perform a cost realism analysis that takes into consideration each team members rates (*Metro Machine Corp., B-297870.2*). The agency engaged in improper cost realism analysis in the form of "normalization" of proposed costs i.e. making adjustments to all proposals in the same way when offerors had proposed different techniques to carry out the work (*Information Ventures, B-297296.2*).

FAR 9.104 states that for an offeror to be considered *responsible*, it must, among other things, be able to comply with the required performance schedule, have adequate financial resources, and have the necessary organization, experience, operational controls and technical skills or the ability to obtain them. The burden falls on the contractor to demonstrate its responsibility and in the absence of information clearly indicating responsibility, the CO must make a determination on non-responsibility. The Court rules it will not disturb a non-responsibility determination unless the protester can show the agency had no reasonable basis for its determination – simply put, this is a matter where the CO is vested with broad discretion in exercising its judgment (*United Enterprise & Assoc. v US, 70 Fed. Cl. 1*). In a decision related to the offeror's capability to perform the work, the Court ruled such a decision constituted a non-responsibility determination where the CO was given the benefit of the doubt (*Fabritech, Inc. B- 298247*).

There were many cases addressing firms' organizational conflict of interest (OCI). The GAO ruled there was an "impaired objectivity" OCI that resulted from the contractor's continuing to receive payment from a firm over which it would have management responsibility (*Greenleaf Construction, B-293105*). The GAO also ruled there was an impaired objectivity OCI where several evaluators were employed by firms that promoted a type of technology that was directly challenged by that offered by the protester. It ruled the agency's reliance on the evaluator's self-certification of the absence of COI did not meet its obligation to ensure no COI existed, especially where the evaluators worked for a firm whose "economic lifeblood" was directly competitive with the other technology (*Celdon Labs, B-298533*). The GAO also ruled there was an OCI in providing a spectrum of engineering support services to a contractor who was involved in the manufacture and marketing of spectrum-dependent products (*Alion Science and technology, B-297342*).

On the other hand, no serious OCI existed where there was limited opportunity for COI and there was a mitigation plan in place by the agency (*Overlook Systems Technologies , B298099*). Even though one of the awardee's joint venture partners could be providing contract close-out services on awardee's task orders no OCI existed because such services did not involve judgment, evaluation or assessment in performance of the contract (*Leader Communications, B-298734*). The Court found that the awardee, as the incumbent contractor, did not have the type of specific, sensitive information that would create an OCI holding that an incumbent status, without more, typically does not constitute "unequal access" to information sufficient to constitute OCI (*Systems Plus v US, 69 Fed. Cl. 757*). The Court also found that awardee did not gain unequal access to information where the information is in the public domain, did not quality as bid and proposal information, was not proprietary or did not result in any unfair advantage (*Avtel Svcs v US, 70 Fed. Cl 173*). The GAO ruled the fact the supervisor of two of the evaluators was a former employee of the awardee did not afford the awardee an unfair advantage because the supervisor did not exert improper influence in the procurement. The GAO also found there was no OCI even though a subcontractor of the awardee was a former agency official who had served as an evaluator of the proposal of the protester in a prior procurement because the former official had signed a nondisclosure agreement and his only involvement in the preparation of the proposal was limited to submission of a subcontract proposal (*Maden Technologies, B-298543.2*).

Agencies generally must include all of the most highly rated proposals in the *competitive range*. An agency is not required to retain in the competitive range a proposal that has no realistic chance for award and may exclude such a proposal even if such exclusion results in a competitive range of one (*Brian X. Scott, B-208568*). But it was not reasonable to eliminate an offeror from the competitive range when the awardee's initial proposal was "technically unacceptable" while the excluded protester was "highly acceptable" and the basis for exclusion was a 15% higher proposed price (*Global A 1st Flagship, B-297235*).

♦ Past Performance

FAR 15.304 requires that past performance be one evaluation factor that must be considered in all negotiated procurements and the boards and courts are defining how this new factor will be applied. When negotiated awards are to be made with discussions offerors are to be given the opportunity to clarify adverse past performance while negotiated awards that do not provide for discussion *may* be given the opportunity to clarify past performance. An agency is not required to communicate with offerors past performance information where discussions are not held unless there is a clear reason to question the validity of the past performance information (*Bannan Inc. B-298281.2*).

An agency has broad discretion in determining whether a particular contract is relevant (*Poly-Pacific Technologies, B-295496.3*). The GAO held that the agency's approach to evaluating past performance was unreasonable because it had the effect of penalizing offerors with relevant past performance and irrationally gave equal weight to both highly relevant and non-relevant performance (*United Paradyne, B-297758*). The GAO found it was reasonable for the agency to place emphasis on the protester's performance on the incumbent contract since that performance may be viewed as a more accurate indicator of future performance than any other (*Del-Jen Int'l, B-297060*). In another decision GAO ruled the evaluation of past performance was not objectionable where the agency reasonably concluded that only of four prior contracts was of a magnitude and complexity to meet contract requirements while the other two were evaluated as only semi-relevant and the fourth as not relevant (*East-West Industries, B-297391*). The GAO said there was no legal requirement that all past performance be checked or reviewed in a valid review of past performance (*Dismas Charities, B-298390*). In another decision the Board made the point that relevance of past performance should be left to the agency and that an evaluator's personal knowledge may properly be considered (*John Blood, B-298841*). It is proper to consider other relevant information in its possession regarding the offeror's past performance beyond that provided by the offeror (*The Arona Group, B-297838.3*). It is reasonable to consider relevant only that past performance related to similar tasks performed under government contracts. The agency properly exercised its discretion in deciding not to consider the experience of key personnel in evaluating a protester's past performance (*JWK Intl Group, B-297758.3*).

It is the *contractor's responsibility* to provide sufficient evidence to establish its past performance history. When the contractor, in response to a CO's request, provided only irrelevant or outdated information on the past performance information on a subcontractor the Court found the CO acted reasonably in awarding the subcontractor a neutral rating which lowered the protester's overall score (*RISC Management Joint Venture v US (69 Fed.Cl. 624*). Though the solicitation required offerors to provide a list of references of relevant contracts performed in the last three years and to ensure the references completed a questionnaire, the GAO denied a protest where the protester provided questionnaires on only three of 10 references and none of them were relevant to the solicited contract (*American Floor Consultants, B- 294530.7*). A brief two-paragraph discussion of experience and past performance was determined to not meet the solicitation's detailed requirements for past performance information (*Prudent Technologies, B-297425*).

An agency properly may *attribute* the experience or past performance of a parent or affiliated company to an offeror where the proposal demonstrates the resources of the parent or affiliate will affect performance of the offeror. The GAO ruled the agency reasonably assigned an acceptable rating to protester despite its lack of experience based on its mentor's past performance (*IPlus, Inc.*). A protest was sustained where the agency found the protester's proposal was unacceptable because it did not meet past performance requirements, arguing it was contrary to the solicitation's evaluation criterion that allowed requirements to be met by either the contractor or a properly committed subcontractor (*KIC Development, B-297425.2*).

♦ Discussions

FAR 15.306 requires the CO discuss with each offeror being considered for award significant weaknesses,

deficiencies or other aspects of its proposal that could be altered or explained to enhance the proposal's potential for award. Discussions should not be confused with *clarifications* which are limited exchanges with offerors to allow correction of minor or clerical errors or to clarify proposal elements. No discussions occurred where the exchanges did not lead to a material revision of the vendor's quotation and the vendor's competitive position remained the same (*Language Svcs Assocs., B-297392*). Communications that merely confirm what the offeror is already committed to doing does not constitute discussions (*United Medical Systems, B-298438*). An agency's communications with awardee following submission of final offers during which awardee made various changes constituted discussions and required the agency to similarly conduct discussions with the protester (*CIGNA Gov. Svcs, B-297915.2*). An agency conducted discussions not mere clarifications when the information was needed to determine whether the proposal was acceptable (*General Injectibles, B-298590*). While the protester claimed the agency held discussions with various offerors regarding their failure to comply with solicitation instructions but refused to do so with it, the agency claimed these communications were mere clarifications. The GAO found that in response to these "clarifications" several offerors made substantial changes to their proposals and hence ruled any communications that allow such changes are considered discussions (*Univ. of Dayton Research Institute, B-296946.6*).

It has been held there is no requirement that all areas of a proposal be addressed during discussions but only *significant* weakness e.g. those having an appreciably increase in risk of unsuccessful contract performance (*Standard Communications, B-296972*). There is no requirement that an agency inform an offeror that its price is too high where the price is not considered to be excessive or unreasonable (*DeKekion Security Systems, B-298235*).

Discussions must also be *meaningful*. The GAO ruled it is the responsibility of an agency to lead offerors into areas of their proposals that need revision (*Global A 1st Flagship, B-297235*). The GAO ruled that an agency's price discussions unreasonably favored the awardee where though the protester's price was significantly higher, the agency used "softer" language in discussing the protester's price as "high" than in discussing the awardee's price as "excessive" (*Syronics, B-297346*). Discussions were ruled misleading where the agency identified certain hourly rates as significantly higher than the government's estimate making the offeror deduce that rates not identified were not too high which resulted in the protester leaving those rates unchanged (*Multimax, B-298249.6*).

Claims

When contract effort exceeds the original scope of work the contractor is entitled to receive a price adjustment to the contract price. An equitable adjustment is the difference between the reasonable cost of the work required by the contract and the actual reasonable cost to the contractor of performing the changed work, plus a reasonable amount of overhead and profit. A contractor generally carries the burden of proving the amount by which a change increased its cost of performance. The following address circumstances when a claim may be justified and some issues related to quantifying the price adjustment.

♦ Constructive Changes

A constructive change occurs when a contractor must perform work beyond contract requirements without a formal "order" to do so under the "Changes" clause. Such a change can include an *informal* order or direction of the government or by the *fault* of the government. To recover under this theory the contractor must advise the government it considers the contract to have changed. A constructive change was ruled to have occurred where the government enlarged the performance requirements (*MA DeAtley Construction v US, 71 Fed. Cl. 370*). The Board held the government can be placed on notice of a claim by being made aware of the operative facts and that oral notice may be furnished. The Board further held that the government has the burden to prove prejudice (i.e. harm) from a lack of notice and this burden cannot be met by mere allegation but must be supported by evidence from the record (*SUFI Network Svcs, ASBCA No. 55306*).

A contract may be *accelerated* by a specific direction or by a constructive order by the government where there is an excusable delay, a request for a contract extension or denial of the request for time extension, government insistence on timely completion and extra expenses on the part of the contractor (*Curry Contracting, ASBCA No. 53716*). The Court held the same analysis should apply where extra work resulting from a differing site condition takes the place of the excusable delay in the analysis (*Ace Constructors v US, 70 Fed. Cl 253*). The Board found the government had ordered the contractor to accelerate its performance to achieve substantial completion by

Memorial Day which was less time than allowed by contract terms and thus was entitled to an equitable adjustment under the "Changes" clause (*Imperial Construction, ASBCA No. 54175*).

Costs

Termination Settlement Costs In its suit against its prime contractor, the Court ruled language in the subcontract termination for convenience clause limiting recovery to the subcontract price meant the subcontractor could recover its total costs reasonably incurred up to the total contract price rather than be restricted to the subcontract prices of the individual line items (*AMC Demolition Specialists v. Bechtel Jacobs, 2006 WL 279401*). An earlier 2005 decision on a cost sharing contract held the contractor could recover only 80% of its pre-termination costs because the cost-sharing provisions of its contract applied to terminations for convenience. A higher court rejected the decision finding the termination clause's requirement to pay "all cost reimbursable" defined the type of costs not the amount. The court observed that cost-sharing contracts are appropriate when the contractor agrees to absorb a portion of costs in the expectation of receiving substantial compensating benefits and as a result of a termination the contractor here was denied the opportunity to obtain those results (*Jacobs Engrg v US, 434 F.3d 1378*). The court denied reimbursement of costs for software and warranty services after a termination ruling that after a contract has been terminated, there is no longer an obligation to perform any contractual duties and hence no obligation to pay (*Int'l Data Pdts v US, 70 Fed. Cl. 387*).

Independent Research and Development. In 2003 the Court ruled that work implicitly required by a contract does not qualify as independent research and development stating the dividing line between IR&D and work required in performance of a contract is not whether the work is explicitly or implicitly required but rather whether the work is performed before or after the contract is signed (*US v Newport News Shipbuilding, 276 F. Supp.2d 539*). Another Court reached the opposite result holding whether a cost is required in the performance of a contract is controlled by the contracting parties' intent as determined by traditional contract interpretation on a case-by-case basis. In that case, the contractor's commercial contract expressly excluded certain development costs that were implicitly required to perform the contract and the court approved of the allocation of the costs to IR&D (*ATK Thiokol v US, 68 Fed. Cl. 612*). Another Court held that a contractor can conduct IR&D work and contract work in the same subject area without losing patent rights if it carefully documents costs and the precise work done on each project (*Boeing Co. v US, 69 Fed. Cl. 397*)

Legal Costs. The contractor went through a number of investigations at its training center where the court ruled all were part of the same "proceeding." Though one of the investigations did not result in any criminal wrongdoing others did and hence all legal costs related to the proceeding were disallowed since some of the investigations resulted in a criminal conviction of a contractor employee (*Dyncorp, ASBCA No 49714*).

Contract Administration. For a long time boards and courts have distinguished between unallowable costs or prosecuting claims and allowable costs of contract administration where in a seminal case (*Bill Strong*) the basic guidance is that if the costs are incurred to permit a negotiated resolution of the problems that arose during contract performance they are presumably allowable costs of contract administration while if they are incurred to begin the process of litigation they are unallowable. The fact the contractor met with the government and recommended a negotiated settlement did not establish that its underlying purpose for incurring the legal costs was furthering the negotiation process rather than prosecuting a claim (*Bath Iron Works, ASBCA No 54544*).

State Taxes. In reversing an earlier decision, the Court held that state income taxes paid by a Subchapter S corporation on behalf of its sole shareholder were not allowable costs (*Information Systems & Networks Corp. v US, 437 F.3d 1173*).

Limitation of Funds. Under a level-of-effort contract covering a series of task orders and subject to the "limitation of funds" clause the contractor properly notified the agency when it reached the funding limit on several task orders but the ACO sent the contractor a cure notice stating it would terminate the contract unless it continued performance. The contractor resumed performance, notifying it intended to claim costs over the contract ceiling. The board ruled that when the government demands and obtains the fruit of contractor's efforts knowing the contractor is in an overrun position the contractor is entitled to recover its costs regardless of the "Limitation of Funds" clause (*Base Technologies v Dept of Transportation, DOTBCA No. 4538*). The contractor's responsibility to review a subcontractor's request for an equitable adjustment before submitting it to the government

does not excuse the contractor from giving timely notice of the "Limitation of Cost" clause. The Board ruled the clause does not limit a contractor's notice obligations to those cost proved to be allowable to a "certitude" but rather the notice is required when the contractor "has reason to believe" of expected costs increases (*International Technology, ASBCA No. 54136*).

Defective Pricing. The Truth in Negotiations Act defines "cost or pricing data" as all facts that, as of the date of agreement on price, a prudent buyer or seller would reasonably expect to affect price negotiations significantly." The Court found that subcontractors did not violate TINA where they had preliminary plans to negotiate lower prices but no actual agreement to do so by the date the contract was finalized and there was no duty to disclose actual agreement to lower the price because it was made 13 months after the contract was finalized (*US v Allison Engineer Co, 471 Fed 610*).

RECENT DECISIONS ON TRAVEL AND RELOCATION

(*Editor's Note. Though only three parts of the Federal Travel Regulations provisions formally apply to government contractors – combined per diem rates, definitions of meals and incidentals and conditions justifying payment of up to 300% of per diem rates – many contractors choose to follow the FTR either because some contracts call for incorporation of it or auditors and contractors consider it to be the basis for determining "reasonableness". This feature is a continuation of our effort to present new changes or decisions likely to affect contractors' travel and relocation expenses.*)

Rental Car Reimbursement Limited to Agency Negotiated Fee

Infante rented a car during his temporary duty assignment (TDY) with the Defense Department (DOD) in Italy. Rather than rent through Europcar, the rental agency DOD had negotiated a lower rate with, Infante rented a car from Avis because he did not like the way DOD reimbursed for value added taxes in its agreement with Europcar. He paid the rental fees, which were five times those negotiated with Europcar and when he sought reimbursement DOD refused to pay the entire amount stating it would limit reimbursement to the cost Infante would have incurred had it rented from Europcar. In its appeal asserting DOD could not force him to use Europcar, the board agreed DOD could not force him it to use Europcar but nonetheless ruled DOD correctly limited his reimbursement stating the JTR require employees traveling on official business to "exercise the same care and regard for incurring expenses paid by the government as would a prudent person traveling on personal business." Here, a prudent person would not pay five times more for a rental car simply because it did not like its tax reimbursement method and hence DOD could force him to accept the limited reimbursement amount (*GSBCA 16937-TRAV*).

Buy a New Home Before Traveling - Not After

Tennant was stationed in the Netherlands on a three year tour of duty with the Drug Enforcement Agency (DEA) and anticipating relocation to Washington DC headquarters, placed a contract on a house near Washington Dec. 2005. His belief he would be transferred to Washington was based on (1) DEA written guidelines providing someone in his position would be rotated into "HQS (headquarters) positions" and (2) emails by a DEA official responsible for international programs confirmed Tennant would be transferred. Tennant closed on the house in Dec. 2005, received written transfer orders in Feb. 2006 and transferred in March 2006 but DEA refused payment to reimburse him for costs of buying a new house stating the purchase of the new house was not necessarily related to his transfer because he made the purchase before he received transfer orders. In his claim the guidelines and emails indicated a clear administrative intent to transfer him to DC, the Board sided with DEA stating (1) the guidelines called for transfers to a headquarters position where such positions are located in several locations and were too general to be taken as an expression of intent and (2) the email statements though they could be construed as clear administrative intent, occurred a month after Tennant placed a contract on the home (*CBCA 553-RELO*).

Reimbursed For Actual Not "Could" Expenses

In his travel from Washington DC to Chattanooga, TN Shelton chose to drive his motor home and stay in the vehicle rather than fly to his destination as his travel orders authorized. The government reimbursed him $753 for his mileage, per diem and lodging expenses but rejected Shelton's request to be reimbursed $1,078 for air travel and hotel he would have incurred. The new Civilian Board ruled it does not matter how much *could* have been incurred ruling federal employees are only entitled to reimbursement for total allowable costs they *actually* incurred (*CBCA 473-TRAV*).

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Quitting Job Earlier Than 12 Months Not "Beyond Her Control"

As part of her transfer to New Orleans, Fournier signed a service agreement promising 12 months of government service in return for the government paying her relocation costs. The agreement provided that if she separated from the government before serving 12 months she would have to repay the relocation reimbursement unless she was separated for reasons beyond her control. After her transfer Fournier's husband, unable to find a suitable job in New Orleans, accepted a job in New Mexico at Kirtland Air Force Base and in order to be with him, left her job after four months. When the Air Force asked Fournier to repay her relocation expenses she argued her husband's relocation caused her to separate from the government for a reason beyond her control. The Board disagreed stating the Air Force position was reasonable and a previous decision found an employee's resignation in order to accompany a transferred spouse was not a separation beyond the employee's control (*GSBCA 14724-RELO*).

Limit Reimbursement to Costs of Direct Route

In his trip from Maryland to Alaska to support missile tracking tests, Jacobs received advanced approval to fly from Baltimore-Washington Airport (BWI) to Anchorage Alaska. A week before travel, Jacob's mother-in-law died and the family went to attend her funeral in Florida and he was given permission to fly from Florida rather than BWI to Anchorage. When a claim was submitted the agency reimbursed Jacobs only for the cost of the round trip between BWI and Alaska, rejecting the additional cost of $597 for his departure from Florida. In his appeal, the Board first established the basic rule: an employee on temporary travel must travel by the usual travel route unless an agency authorizes a different one. If the indirect route is used or interrupts travel for his personal convenience, the employee's reimbursement is limited to "the cost of travel by a direct route or on an uninterrupted basis" (FTR 301-10.7). The Board concluded the agency was correct in limiting reimbursement between the BMI-Alaska route (*CBCA 471-TRAV*).

Not Entitled to Cleaning Deposit When Leaving a Messy Apartment

Henderson was transferred to Washington DC where his apartment rental agreement called for return of his security deposit of $695 if he met all stipulated conditions. Upon leaving the landlord billed Henderson $935 for costs of painting, cleaning,

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carpet cleaning, maintenance and damage repairs – keeping his deposit of $695 and asking repayment of an additional $240. The board rejected Henderson's claim to be reimbursed the $935 stating security deposits must be repaid as the cost of breaking a lease but only if (1) the employee actually incurred the expenses (2) the lease terms provided for payment and (3) the expenses cannot be avoided. Here the board ruled the $935 was not unavoidable because in incurring the expenses he had failed to leave the apartment in an acceptable condition (*CBCA 651-RELO*).