The Comptroller General
of the United States

Washington, D.C. 20548

Decision

Matter of: Lecher Construction Co.

File: B-224357

Date: September 30, 1986

DIGEST

Clause in an invitation for bids for a fixed-price construction contract that limits the allowable percentage of profit on certain change orders is inconsistent with the Federal Acquisition Regulation (FAR), 48 C.F.R. § 15.901(c), which prohibits administrative profit ceilings that are less than any applicable statutory ceilings.

DECISION

Lecher Construction Company protests the inclusion of a supplemental changes clause in invitation for bids (IFB) No. 570-68-86, issued by the Veterans Administration Medical Center, Fresno, California, for a fixed-price construction contract. The protester contends that the clause, which limits allowable profit in contract price increases resulting from change orders, is inconsistent with applicable procurement regulations and guidelines. We sustain the protest.

Lecher initially protested to the agency. Following the VA's denial of its protest, the firm protested to our Office on June 18, 1986. At bid opening on June 24, the VA received three bids, including Lecher's low base bid.

The solicitation clause at issue supplements the "Changes" clause prescribed by the Federal Acquisition Regulation (FAR), 48 C.F.R. § 52.243.4 (1985), which governs changes in the work under fixed-price construction contracts ordered by contracting officers. The VA clause addresses adjustments to the contract price as follows:

> "(d) Allowances not to exceed 10 percent each for overhead and profit for the party performing the work will be based on the value of labor, material, and use of construction equipment required to accomplish the change. As the value of the change increases, a declining scale will be used in negotiating the percentage of overhead and profit. Allowable percentages on changes will not exceed the following: 10 percent

> overhead and 10 percent profit on the first $20,000; 7-1/2 percent overhead and 7-1/2 percent profit on the next $30,000; 5 percent overhead and 5 percent profit on balance over $50,000. Profit shall be computed by multiplying the profit percentage by the sum of the direct costs and computed overhead costs."

48 C.F.R. § 852.236-88(b) (1985).

Lecher argues that this clause is inconsistent with the prohibitions on profit ceilings contained in the FAR, 48 C.F.R. § 15.901(c), and Office of Federal Procurement Policy, Policy Letter 80-7, "Policies for Establishing the Profit or Fee Prenegotiation Objective," 45 Fed. Reg. 82,594 (1980). We need only address the consistency of the VA clause with the FAR, since Policy Letter 80-7 was developed with the intention of incorporation in the FAR when it was promulgated, 44 Fed. Reg. 12,225 (1979), and by its own terms expired upon issuance of the FAR on September 19, 1983. 45 Fed. Reg. 82,595 (1980).

Subpart 15.9 of FAR, entitled "Profit," prescribes policies for establishing the profit or fee portion of the government's prenegotiation objective. It applies to price negotiations based on cost analysis. The FAR recognizes that "negotiation of extremely low profits, use of historical averages, or automatic application of predetermined percentages to total estimated costs do not provide proper motivation for optimum contract performance." 48 C.F.R. 15.901(c). Accordingly, except for statutory ceilings on profits, agencies may not "(1) establish administrative ceilings or (2) create administrative procedures that could be represented to contractors as de facto ceilings" when conducting price negotiations based on cost analysis. Id. The FAR requires use of a "structured profit approach" for agencies that make sizable noncompetitive awards, and it lists factors to be used in developing a structured approach and in analyzing profit, whether or not a structured approach is used. These factors include contractor effort, contract cost risk, and capital investment. 48 C.F.R. §§ 15.902; 15.903; 15.905-1.

In response to the protest, the VA suggests that the FAR prohibition on profit ceilings may apply only to negotiation of basic contract prices, and not to negotiation of changes in the prices of fixed-price contracts, as here. FAR subpart 15.9 applies to price negotiations based upon cost analysis, 48 C.F.R. § 15.900(b), and such negotiations are conducted with respect to modifications as well as basic contracts. 48 C.F.R. § 15.800. While one provision of subpart 15.9

allows contracting officers to use the basic contract profit rate when negotiating the prices of many changes or modifications, we find no general exception from the prohibition on profit ceilings for such negotiations. 48 C.F.R. § 15.903(f). Thus, although contractors are only entitled to reasonable profits for increased work under change orders, see Keco Industries, Inc., Armed Services Board of Contract Appeals, No. 18,730, May 8, 1974, reprinted in 74-2 BCA ¶ 10,710 (CCH 1974), agencies may not predetermine acceptable profit levels through administration ceilings without obtaining a deviation from the FAR in accordance with 48 C.F.R. subpart 1.4.

The VA also argues that the United States Court of Appeals for the Federal Circuit has upheld the challenged clause in a decision addressing the portion restricting recovery of overhead costs, Sante Fe Engineers, Inc. v. United States, No. 85-2682 (Fed. Cir. Apr. 18, 1986). That unreported decision concerned only interpretation of the language of the VA clause in connection with overhead costs incurred during a delay, and is irrelevant to the issues raised in this protest.

Finally, the VA claims that its clause constitutes a "structured approach" permitted by FAR, 48 C.F.R. § 15.902. We find no merit in this contention. VA's approach is clearly an administrative profit ceiling based solely upon the contractor's cost of performance. It is not a "structured approach," which is a method for determining the government's prenegotiation profit objective based upon the contractor's risk, effort, cost-control and other past accomplishments, socioeconomic programs, capital investment, and other factors prescribed by FAR, 48 C.F.R. § 15.905-1.

We conclude that the VA clause is inconsistent with FAR, 48 C.F.R. § 15.901(c), and we are recommending that the VA follow the procedures required for deviating from the FAR in 48 C.F.R. subpart 1.4 or revise the IFB so that its clause governing the establishment of prices for change orders is consistent with the applicable procurement regulation.

The protest is sustained.

Milton J. Socolar

for Comptroller General
of the United States