

Van Schaik



The Comptroller General  
of the United States

Washington, D.C. 20548

# Decision

Matter of: PAI, Inc.

File: B-230610

Date: July 12, 1988

### DIGEST

1. Protest is sustained where, in violation of solicitation provision, agency failed to upwardly adjust awardee's estimated labor rates in cost realism analysis even though contracting officials expressed concern that the labor rates included deflated hourly rates, i.e., rates based on an individual working more than 2,080 hours per year.

2. Provision in solicitation for cost reimbursement type contract that cautions offerors not to use deflated hourly rates, i.e., rates based on an individual working more than 2,080 hours per year, should be read as requiring that cost estimates based on deflated hourly rates will not be accepted as is but will instead be adjusted in the cost realism analysis to take deflated hourly rates into account.

### DECISION

PAI, Inc., protests the award of a contract to Resource Consultants, Inc., under request for proposals (RFP) No. N00039-87-R-0117(Q) issued by the Navy's Space and Naval Warfare Systems Command (SPAWAR) for engineering and technical support services. PAI contends that Resource's proposal was based on deflated hourly labor rates and SPAWAR's failure to adjust Resource's cost estimate to compensate for this resulted in SPAWAR's failure to properly evaluate that firm's cost proposal. We sustain the protest.

The solicitation requested proposals for a base and four option years. Under the solicitation's level of effort clause, the total staff hours of direct labor required for each of the four option years was 98,390, 97,890, 108,850 and 113,850. The solicitation contemplated award of a cost-plus-fixed-fee (CPFF) contract to be performed through the issuance of task orders for 13 tasks set out in the RFP.

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The RFP included three minimum requirements that must be met for a proposal to be considered for award: (1) a work site within a 25-mile radius of SPAWAR's offices, with sufficient resident professional staff to provide a quick reaction capability; (2) acceptance of an organizational conflict of interest clause, and (3) a secret facility clearance. The technical evaluation, which was considered by the RFP to be substantially more important than estimated cost, included consideration of, in descending order of importance, technical approach, personnel experience, management structure and corporate experience.

The RFP stated that the cost evaluation will consider the two following factors of equal importance: total proposed cost and reasonableness/realism of labor costs with respect to the proposed labor mix. Thus, under the source selection plan (SSP), total proposed cost and cost reasonableness/realism were each assigned 20 points. Also, the RFP indicated that cost estimates would be evaluated to determine if they are "reasonable and realistic" for the proposed technical/management approach as well as to determine the offeror's understanding of the effort. Finally, the RFP stated:

"Offerors are cautioned not to use deflated hourly rates, i.e., those based on an individual working more than 2080 hours per year. Offerors are required to meet the full level of effort specified. The evaluation of costs will therefore include an evaluation of the suitability of the categories of labor offered and the number of hours for each category, i.e., the mix of labor relative to the total level of effort required."

SPAWAR received five initial proposals including proposals from PAI and Resource. As part of the cost evaluation, according to SPAWAR, its negotiator verbally verified the offerors' proposed rates with the Defense Contract Audit Agency (DCAA). This rate check consisted of the contract negotiator asking a DCAA auditor to compare the offeror's labor rates for each proposed position with those that DCAA had previously approved for billing and payment purposes. The rate check included rates for such indirect cost categories as general and administrative (G&A) and overhead and included a check of subcontractors' proposed rates.

According to SPAWAR, each member of the evaluation panel also individually reviewed each cost proposal for realism/reasonableness of labor costs according to the criteria of the RFP. The evaluation panel chairperson applied predetermined weights set out in the agency's SSP to raw evaluation

scores provided by the evaluation panel. The results for the protester and the awardee, which include the scoring for both technical and estimated cost factors, were as follows:

<u>Offerors</u>	<u>Total Points</u>
Resource	79.41
PAI	79.05

The chairperson forwarded to the contracting officer the evaluation panel's report including raw evaluation scores, weighted scores, a competitive range recommendation of PAI and Resource and negotiation questions for those two firms. PAI proposed an estimated cost of \$12,512,649 while Resource proposed an estimate of \$9,955,085. The only negotiation questions regarding the offerors' cost proposals related to ensuring that subcontractors provide complete cost data. The contracting officer, as the source selection authority, accepted the evaluation panel's competitive range recommendation and forwarded the negotiation questions to PAI and Resource and requested best and final offers (BAFOs).

PAI and Resource submitted timely BAFOs. Both offerors reduced their total estimated costs; PAI reduced its estimate to \$11,813,120 and Resource reduced its estimate to \$8,140,133. The BAFOs were reevaluated by the evaluation panel. The contract negotiator again checked the offerors' proposed labor rates against current DCAA rates that the firms had billed on other contracts. With respect to Resource, the DCAA rate check revealed that six of the firm's proposed labor rates were identical to what the firm currently was billing while the five remaining rates were, according to SPAWAR, "very close" (within 5 to 20 percent).

The evaluation panel chairperson then reapplied the evaluation formula set out in the SSP and arrived at the revised weighted scores including cost scores of 77.90 for PAI and 81.13 for Resource. Out of 20 possible points for total estimated cost, Resource received 20 points while PAI received 10.98 and for cost reasonableness/realism, out of 20 possible points, Resource received 14 points while PAI received 16.40 points. The evaluation panel recommended to the contracting officer award to Resource. In the evaluation panel's report on the BAFO evaluation, the panel chairperson concurred in the award recommendation but noted a "severe reservation regarding cost," since some of Resource's proposed staff hour rates were lower than industry standards. The contracting officer accepted the recommendation to award to Resource and, in a memorandum to the file, noted the concerns of the evaluation panel regarding estimated costs, but stated that "due consideration had been given to that in my determination. It is my

opinion that close management and careful attention to tasking by the Government will eliminate any reservations that the [evaluation panel] has toward the cost proposed by [Resource]."

The contracting officer's recommendation of award to Resource was forwarded to SPAWAR's Executive Director for Contracts who noted with regard to Resource's proposal: "The labor rates appear to be unrealistically low. . . . I am concerned that the contractor is playing a game, but I am not sure how to prevent it. . . ."

In response to these concerns, the contracting officer attempted but failed to negotiate with Resource a cap on labor rates or a limit on indirect costs. According to SPAWAR, the contracting officer and the contracting officer's technical representative (COTR) decided on a plan for controlling hours worked and expenditures under the contract by tightly controlling the labor rates and hours and work to be performed under each task order.

Based on the slight technical difference between the two competitive range offerors--PAI scored 50.52 under all the technical factors and Resource 47.13--and Resource's significant estimated cost advantage, SPAWAR awarded the contract to Resource.

PAI's principal complaint is that Resource's proposal is based on the use of deflated hourly labor rates in violation of the RFP prohibition and that SPAWAR failed to apply that prohibition in evaluating Resource's proposal. In this respect, PAI maintains that Resource's professional employees that are exempt from the 40 hour work week requirement of the Fair Labor Standards Act generally work greater than 40 hours a week and that Resource's proposed labor rates are based on greater than 40 hour work weeks, or more than 2,080 hours per year (52 weeks per year multiplied by 40 hours per week equal 2,080 hours).

In support of its position, PAI submitted statements from a number of former Resource professional employees stating that they routinely worked greater than 40 hours a week. Further, PAI argues that the large total difference in the estimated costs between its proposal and Resource's can only be explained by Resource's use of deflated hourly rates.

PAI argues that the deflated hourly rate clause of the solicitation requires that the agency affirmatively determine as part of its evaluation of cost realism that the hourly rate for each employee in each offeror's proposal is based on 2,080 hours per year. To do so, according to PAI, SPAWAR could not simply compare estimated rates by position

with DCAA approved rates without verifying whether those previously approved rates were based on deflated labor hours. In this respect, PAI argues that SPAWAR merely assumed that DCAA approved rates from previous Resource contracts were based on 2,080 hours and that agency officials did not ask DCAA about deflated hourly rates during proposal evaluation. Moreover, according to the protester, none of the actions taken by SPAWAR and described in the agency's report demonstrate that the agency verified whether Resource used deflated hourly rates in its cost estimate.

In response to PAI's allegations, SPAWAR maintains that it properly evaluated proposals in accordance with the solicitation's evaluation scheme including the caution concerning deflated labor hours. SPAWAR explains that the contract negotiator's verbal rate check confirmed that Resource was using labor rates in its estimate in accordance with DCAA approved rates. Further, SPAWAR says that, based on a recent audit, DCAA determined that Resource's direct and indirect costs, including hourly rates, were reasonable, allowable and properly allocable under the cost principles. According to SPAWAR, based on this review, the contract negotiator concluded that there was no evidence to suggest that Resource's proposal included deflated hourly rates. SPAWAR also explains that each member of the evaluation panel reviewed and scored each proposal for cost reasonableness/realism based on the SSP and the criteria of the RFP, including consideration of the estimated staff hours.

Under a cost-reimbursement type contract, an offeror's proposed costs of performance should not be considered controlling since the estimates proposed may not provide valid indications of final actual costs. Federal Acquisition Regulation (FAR) § 15.605(d). Accordingly, where as here, the RFP contemplates the award of a cost-type contract, the agency is required to analyze each offeror's estimated costs for realism. Kinton Inc., B-228260.2, Feb. 5, 1988, 67 Comp. Gen. \_\_\_\_, 88-1 CPD ¶ 112. Moreover, when an offeror's proposed labor rates are found to be understated, the contracting agency has an obligation to adjust those rates for purposes of the evaluation. See Hardman Joint Venture, B-224551, Feb. 13, 1987, 87-1 CPD ¶ 162; Marine Design Technologies, Inc., B-221897, May 29, 1986, 86-1 CPD ¶ 502; Computer Sciences Corp., B-210800, Apr. 17, 1984, 84-1 CPD ¶ 422. Such a determination of evaluated realistic costs is nothing more than an informed judgment of what costs should be reasonably incurred by accepting a particular proposal. CACI, Inc.-Federal, 64 Comp. Gen. 71 (1984), 84-2 CPD ¶ 542. A contracting agency's analysis of cost estimates involves the exercise of informed discretion and we will not disturb an agency's cost

realism determination absent a showing that it lacks a reasonable basis. DDL Omni Engineering, B-220075, et al., Dec. 18, 1985, 85-2 CPD ¶ 684.

Here, an essential aspect of the required cost realism analysis is the RFP provision relating to the use of deflated hourly rates. We read that provision as stating that cost estimates based on deflated hourly rates will not be accepted as is but instead will be adjusted to take those rates into account in the cost realism analysis. See Hardman Joint Venture, B-224551, supra. Based on our review of the record, we conclude that SPAWAR's cost realism analysis was unreasonable since, in spite of the wide disparity between the hourly rates and total cost estimates of PAI and Resource and in spite of the concerns of a number of contracting officials regarding Resource's hourly rates, SPAWAR did not verify the rates with Resource during discussions or attempt to adjust the rates in the cost evaluation, but simply accepted them as offered. As set out above, the panel chairperson expressed reservations regarding Resource's labor rates and noted that some of the firm's rates were lower than industry standards. Also, the agency's chief procurement executive raised the concern that Resource's labor rates were unrealistically low and that the agency would have no way of holding costs down under the contract.<sup>1/</sup>

We also reject SPAWAR's contention that its contract negotiator verified the realism of Resource's labor rates including compliance with the prohibition on the use of deflated hourly rates by comparing Resource's labor rates to previously billed, DCAA-approved Resource labor rates. Here, a comparison of estimated rates with approved rates would only assure the realism of the estimated rates if those prior approved rates were based on 2,080 hours. During proposal evaluation, however, contracting officials did not ask DCAA whether Resource's previous rates were based on 2,080 hours and there is evidence in the record that tends to confirm that those rates were, in fact, deflated, i.e., based on employees working more than 2,080 hours per year. On March 7, 1988, after the protest was filed, in a written response to a SPAWAR request for updated information regarding Resource's labor rates, a DCAA auditor, referring to the approved rates used for comparison with Resource's proposal, stated "Labor rates are based on actuals and do include uncomp [uncompensated] overtime." The DCAA auditor, in an affidavit submitted in connection

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<sup>1/</sup> In addition, during the evaluation of the initial proposals, two members of the evaluation panel expressed concern that Resource's labor rates were too low.

with the protest, explains that, based on a review of audit files on Resource, she found that Resource had in the past reflected uncompensated overtime in the labor rates which it had billed and which DCAA had approved. The auditor states that no information is available in DCAA files showing the number of hours worked by each Resource employee and that without that information DCAA could not determine what amount, if any, of uncompensated overtime was included in Resource's estimated rates. According to the auditor, if an evaluation of Resource's use of deflated hourly rates is needed, a "special audit" would be necessary.

The DCAA auditor's response confirms our conclusion that SPAWAR did not properly evaluate proposals for compliance with the no deflated hourly rate provision and thus did not reasonably evaluate proposals for cost realism. Prior to the protest, SPAWAR did not attempt to verify whether the DCAA approved rates were based on more than 2,080 hours per year. Although, as the DCAA auditor explains, a special audit would be required to evaluate the possible use of deflated hourly rates, since the RFP required evaluation of cost realism, including compliance with the 2,080 hour requirement, such an audit should have been requested here based on agency concerns regarding such rates.

We also reject SPAWAR's contention that, because of the significant difference in the cost estimates of Resource and PAI, it is not likely that any adjustment of Resource's evaluated costs would affect the selection decision. The agency has not presented adequate evidence to support such a conclusion. There is no information in the record, for instance, to show the number of work hours upon which Resource based its labor rate calculations. Neither we nor SPAWAR knows whether, or to what extent, Resource's estimated labor costs may be understated. As explained by the DCAA auditor, an audit is necessary to make that determination.

Accordingly, we sustain the protest on this basis. Although PAI raises a number of other issues relating to SPAWAR's evaluation of Resource's proposal, including whether the proper labor mix was proposed and whether SPAWAR properly determined whether Resource's personnel were actually located within the required 25 miles, we find that there is clearly no merit to these contentions.

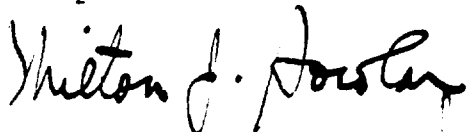
We recommend that SPAWAR reevaluate the realism of Resource's proposed labor rates taking into consideration the caution regarding deflated hourly rates. If necessary, the agency should request a DCAA audit of Resource to determine whether, and to what extent, the firm's cost estimate is based on deflated hourly rates. To the extent that

Resource's cost estimate is based on deflated hourly rates, it should be adjusted for evaluation purposes before rescoreing.

Further, as we noted earlier, the RFP cost evaluation scheme provided that cost estimates be scored a maximum of 20 points for the quantum of the cost estimate proposed and 20 points for the realism of that estimate. Under this scheme, Resource received 20 points for its low cost estimate and PAI only 10.98 points. While the agency attempted to temper this result by also scoring realism (Resource received 14 and PAI 16.40 points under the realism factor), it is clear that Resource's lower estimated cost, despite the serious questions raised as to its validity, resulted in a higher overall cost score. We question this scoring method because it appears to assign a higher score to the lowest estimate without a sufficient adjustment for realism. While it is not possible from the record here to determine exactly how realism was scored, we think that any scoring of the quantum of the costs proposed should be based only on the cost estimate as adjusted in a realism evaluation. See Group Operations, Inc., 55 Comp. Gen. 1315 (1976), 76-2 CPD ¶ 79.

We recommend that the reevaluation be undertaken pursuant to these guidelines and if after the reevaluation, the agency concludes that Resource should not have received the award under the solicitation's evaluation criteria, the contract should be terminated and, if otherwise proper, the award made to PAI. Further, since we have determined that the cost evaluation was not conducted properly, PAI is entitled to the costs of filing and pursuing its protest, including attorneys' fees. Bid Protest Regulations, 4 C.F.R. § 21.6(d) (1988).

The protest is sustained.

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Comptroller General  
of the United States