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DECISION



**THE COMPTROLLER GENERAL
OF THE UNITED STATES
WASHINGTON, D. C. 20548**

FILE: B-189344

DATE: December 6, 1977

MATTER OF: Drexel Industries, Inc.

DIGEST:

Determination that small business is nonresponsible for lack of integrity, because (1) guarantees to provide funds to complete previous contracts were not honored; (2) apparently incomplete financial picture was presented by firm to show financial responsibility; (3) performance had ceased under previous contracts; and (4) firm was found non-responsible under another solicitation over year ago, is not supported by substantial evidence in contract file where problems appear to have been caused by financial circumstances, not lack of integrity, and recommendation is made that matter be submitted to SBA for consideration for COC.

The Naval Ships Parts Control Center (SPCC), Mechanicsburg, Pennsylvania, issued invitation for bids (IFB) No. N00104-77-B-0280 on March 3, 1977, for a quantity of fork lift trucks. The procurement was partially set aside for small business. Bids were received from two bidders, Pettibone Industries, Inc. (Pettibone), a large business, and Drexel Industries, Inc. (Drexel), a small business. Pettibone was awarded a contract for the non-set-aside portion of the solicitation.

During the evaluation of Drexel's bid, SPCC learned that Drexel had two outstanding contracts for fork lift trucks with the Defense Construction Supply Center (DCSC), Columbus, Ohio. Performance under these contracts had ceased in March 1976 although a substantial quantity of trucks remain undelivered.

The following facts emerged after further investigation by SPCC. Drexel was awarded four contracts for fork lift trucks in 1972 by DCSC. The contracts were processed as one production lot. Drexel has reported that it incurred losses on all contracts, but has been able to complete two. In August 1974, after completing delivery of

B-189344

48 out of the total 153 trucks required under contract No. DSA700-73-C-8708 and 79 of the 294 trucks required under contract No. DSA700-73-C-8458, Drexel encountered financial difficulty and requested relief under Public Law 85-804, 50 U.S.C. § 1431 (1970), which authorizes Government agencies to amend or modify contracts if the national defense would be facilitated.

This request was reviewed by the Navy Contract Adjustment Board (NCAB). Relief was granted in the amount of \$599,999.75 by decision dated June 30, 1975, subject to, inter alia, these two conditions:

"h. Prior receipt shall be obtained of a written guarantee made by Drexel Refractories, Inc. [a wholly owned subsidiary of Drexel] by which Drexel Refractories guarantees to provide Drexel Industries, Inc. with any and all funds required to complete performance of the subject contracts in excess of the relief in the amount of \$1,000,000 herein provided;

"i. Prior receipt shall be obtained of a written guarantee made by 15 Broad Street Resources Corp., the American Bank and Trust Company of Reading, Pennsylvania [both firms are major creditors of Drexel], and Robert N. Masucci [president of Drexel], personally, whereby they jointly and severally guarantee to provide any and all funds required to complete performance of the subject contracts in the aggregate amount of up to \$50,000 in excess of the relief in the amount of \$1,000,000 herein provided."
Memorandum of Decision Under Public Law 85-804, Contracts DSA 700-73-C-8458 and -8708 with Drexel Industries, Inc.

These guarantees were obtained by Drexel, as required, and Drexel received the additional funding. The terms of the guarantee obtained from 15 Broad Street Resources Corporation (Broad Street), The American Trust Company of Reading, Pennsylvania (American), and Robert N. Masucci, dated July 2, 1975, required that:

"Any claim under this guarantee must be received by each of the undersigned, at the office set forth above, no later than June 30, 1976, accompanied by a statement supporting the claim."

Between June 1975 and March 1976 Drexel completed delivery of 192 additional fork lift trucks under the two contracts. However, by letter of March 30, 1976, Drexel informed the contracting officer that the contracts could not be completed without additional funding. Shortly thereafter, Drexel ceased performance, leaving a total of 128 trucks undelivered under the two contracts. By letter of May 28, 1976, Drexel requested additional relief under Public Law 85-804 to complete performance. This request is presently under consideration.

B-189344

By telegrams dated June 30, 1976, DCSC informed the guarantors of the July 2, 1975, agreement that Drexel had ceased performance due to a lack of working capital and requested that they make the guaranteed funds available to Drexel for use in contract performance. Broad Street and American replied that they received the telegrams after June 30 and were not, therefore, obligated to provide funds under the terms of the agreement. Mr. Musucci did not specifically admit or deny receipt of the telegram on June 30. DCSC sent a followup letter dated August 5, 1976, to each party asserting that "the Western Union has indicated to this Center that the telegram was delivered to you on 30 June 1976," and again requesting the guaranteed funds. The guaranteed funds have not been transferred to Drexel and the Government has taken no further action to attempt enforcement of the guarantee agreement.

Based on the above facts, SPCC requested that Drexel provide evidence of financial responsibility. Drexel submitted a cash flow statement and a letter from American extending credit to Drexel to provide for projected cash flow peak requirements. SPCC determined that the cash flow statement was predicated upon favorable resolution of Drexel's pending request for relief under Public Law 85-804 and decided that Drexel would not be financially able to meet the solicitation requirements without obtaining the requested relief.

On May 20, 1977, the contracting officer made a determination that, under the Armed Services Procurement Regulation (ASPR) §§ 1-705.4(c)(vi) and 1-903.1(iv) (1976 ed.), Drexel was not a responsible contractor due to lack of integrity. The Determination and Findings (D&F) states that "Drexel Industries, Inc., has a record of failure to perform under contracts due to its neglect to honor commitments made to the Government." As supporting evidence of lack of integrity, the D&F cites the failure of Drexel to provide funds necessary to complete the contracts discussed above under the agreement of July 2, 1975. The D&F also points to a finding that Drexel was nonresponsible with regard to another solicitation, and that the Small Business Administration (SBA) refused to issue a certificate of competency (COC) in that case. Additionally, the D&F states that Drexel apparently based its cash flow statement on being granted relief under Public Law 85-804, and that if the request is denied "there does not appear to be a way, from a financial viewpoint, that Drexel can successfully complete a new contract." In summary, the D&F states:

"* * * there is no evidence to indicate that the contractor has taken any conclusive steps to honor the commitment made to the government to supplement the relief granted under Public Law 85-804 for prior contracts. Rather, the contractor has persistently failed to acknowledge his responsibility by refusing to furnish monies promised and has, in

B-189344

fact, requested additional relief in the face of his prior denial of his own guarantee. Quantities of equipment remain undelivered under the DCSC contracts."

Pursuant to ASPR § 1-705.4(c)(vi) (1976 ed.), this determination and supporting evidence were transmitted to the SBA Regional Office. This regulation authorized SBA to appeal determinations that small businesses were nonresponsible for reasons other than lack of capacity or credit, but left conclusive authority in the contracting agency. The SBA Philadelphia Regional Office appealed the finding of lack of integrity on June 22, 1977.

The SBA appeal stated:

"* * * the contracting officer based his determination of lack of integrity on the firm's 'refusal to meet commitments made to the Government' without analyzing the company's situation, or at least without presenting the facts which precipitated the crisis causing the firm to miss meeting its commitments. In our opinion the firm did not 'refuse' to honor its commitments but rather it was forced by conditions beyond its control to miss meeting its commitments."

Specifically, SBA found that Drexel Refractories, Inc., had provided \$10,000 between June 1975 and May 1976 to support the two contracts in question and had ceased providing funds only when its mine roof collapsed and it had no income. Additionally, SBA concluded that the commitment of July 2, 1975, was not made by Drexel, but by three "financial entities," and that the commitment had expired before a demand to honor it was made by the Government. SBA states that "the firm [Drexel] could not force the financial entities to lend it money or defer action on its debts." Regarding Drexel's suspension of performance, SBA stated "that the firm has and is taking every action it can to perform on the DSA contract, but the escalation in material costs was not within its control * * *."

The Department of the Navy (Navy) denied SBA's appeal and thus affirmed the contracting officer's determination.

Drexel protests the Navy's determination that it lacks integrity. Basically, the protester argues that the evidence relied on by the Navy really involves questions of financial responsibility which, pursuant to ASPR § 1-705.4 (1976 ed.), should have been referred to SBA for COC procedures. If SBA had issued a COC, that would have been conclusive as to Drexel's financial responsibility for this procurement.

B-189344

Drexel argues that the failure of funds to be provided to it under the July 2, 1975, guarantee does not concern Drexel's integrity. First, the protester states that the three guarantors and Drexel are separate corporate or individual entities and are not intertwined in any way and that any breach of the guarantee cannot be imputed to Drexel. Second, Drexel contends that there was no breach as the guarantors were not notified in a timely fashion and by the terms of the guarantee they were no longer required to provide funds.

Regarding the guarantee by Drexel Refractories to provide funds to complete the contracts, Drexel states that a mine roof collapse caused Drexel Refractories to become financially incapable of providing funds. Drexel argues that the failure to meet a financial commitment as a result of an act of God cannot be interpreted as a lack of integrity.

Additionally, Drexel denies that the cash flow statement was predicated on the favorable resolution of its request for further relief under Public Law 85-804. Also, Drexel argues that its nonresponsibility under another solicitation is irrelevant as it was based on different circumstances, over 1 year ago. Drexel states that it has not willfully refused to deliver or perform under the two contracts in question, as the Navy implies, but is financially unable to do so.

The Navy awarded a contract for the set-aside portion of the solicitation to Pettibone on June 24, 1977, notwithstanding Drexel's protest.

Drexel asserts that it was financially capable of performing a contract under the present solicitation as a result of American's credit extension of May 24, 1977, and requests that, since the determination of nonresponsibility was not properly based on a lack of integrity, our Office recommend termination of the set-aside portion of Pettibone's contract and direct the contracting officer to make an award to Drexel.

Before a low bid may be accepted, the contracting officer must make an affirmative determination that the prospective contractor is responsible. ASPR § 1-904.1 (1976 ed.). If the information available to the contracting officer "does not indicate clearly that the prospective contractor is responsible," a determination of nonresponsibility is required. ASPR § 1-902 (1976 ed.). When the prospective contractor is a small business, however, and a determination of nonresponsibility is based on lack of necessary capacity or credit, the matter must be referred to the S&A for possible issuance of a COC. ASPR § 1-705.4 (1976 ed.). Under the statute and regulations effective when the relevant events in this case occurred, if a small business concern was found to be nonresponsible

B-189344

for reasons other than deficiencies in capacity or credit (e.g. lack of integrity, business ethics, or persistent failure to apply necessary tenacity or perseverance to do an acceptable job--not whether the bidder can perform but whether he will perform) then the COC referral was not required and the final decision was made by the contracting officer with approval of the head of the procuring agency. ASPR § 1-705.4(c)(vi) (1976 ed.).

That ASPR provision also requires that a determination that a small business concern is nonresponsible for reasons other than capacity or credit "must be supported by substantial evidence documented in the contract file." Recognizing that questions of responsibility are matters primarily for determination by the procuring agency, we have upheld non-responsibility determinations for reasons other than capacity or credit when the evidence of record reasonably provided a basis for such determinations. 51 Comp. Gen. 288 (1971); 49 *id.* 139 (1969); Kennedy Van and Storage Company, Inc., B-180973, June 19, 1974, 74-1 CPD 334. However, determinations based on a lack of tenacity, perseverance, ethics or integrity have not been upheld when the evidence did not relate to those factors or did not adequately establish a basis for a determination of nonresponsibility. 49 Comp. Gen. 600 (1970); 39 *id.* 868 (1960); The Pulse Companies, Inc., B-184463, June 15, 1976, 76-1 CPD 376.

We have not precisely defined "lack of integrity," but we have held that the causes for suspension of bidders enumerated in ASPR § 1-605.1 (1976 ed.) can be used to determine a bidder's integrity. 39 Comp. Gen. 868, 872 (1960). The Government may suspend a firm or individual--

"(i) suspected, upon adequate evidence, of--

- (A) commission of fraud or a criminal offense as an incident to obtaining, attempting to obtain, or in the performance of a public contract;
- (B) violation of the Federal antitrust statutes arising out of the submission of bids and proposals; or
- (C) commission of embezzlement, theft, forgery, bribery, falsification or destruction of records, receiving stolen property, or any other offense indicating a lack of business integrity or business honesty, which seriously and directly affects the question of present responsibility as a Government contractor; or

"(ii) for other cause of such serious and compelling nature, affecting responsibility as a Government contractor, as may be determined by the Secretary of the Department concerned to justify suspension." ASPR § 1-605.1 (1976 ed.).

B-189344

We have also held that a determination regarding integrity need not be based on standards that rigid, and that each case must be evaluated in light of the particular circumstances involved. Kennedy Van and Storage Company, Inc., supra.

In the present case, we cannot say, from a careful examination of the record, that there is "substantial evidence in the contract file" to support the finding that Drexel lacks integrity. Regarding the failure of funds to be transferred to Drexel under the July 2, 1975, guarantee, the only evidence in the record to support a finding that the guarantee was breached is the unsupported assertion that Western Union advised DCSC that the telegrams were delivered on June 30, 1976. Two of the three guarantors deny this; the other did not directly address the point. Also, as noted above, the Government has taken no further action in pursuit of an enforcement of the guarantee. The telegrams were sent on June 30. It is possible that they were not delivered the same day. Since the terms of the guarantee clearly provide that unless a demand was made by that date the guarantee would expire and since Drexel informed the contracting officer by letter of March 30, 1976, that the contracts could not be completed without additional funding, it appears that DCSC may have contributed to the failure of funds to be provided from that source by waiting too long to make the demand.

We do not think that the failure of Drexel Refractories to provide funds to complete the contract can be grounds for a lack of integrity finding when the cause was a catastrophic accident. From the SBA appeal it appears that Drexel Refractories had been providing funds until the mine roof collapsed.

Further, it is our understanding that the statement in the D&F concerning Drexel's cash flow statement was meant to convey a finding that Drexel had presented an incomplete financial picture and not that the cash flow statement incorrectly included funds not yet granted under the pending request for relief under Public Law 85-804. Again, this is not substantial evidence of a lack of integrity. SPCC asked Drexel for proof that it was financially responsible and Drexel responded with an apparently accurate cash flow statement and a letter of credit from a bank. Since SPCC was acutely aware of Drexel's financial problems regarding the two previous contracts even though they were DCSC contracts, it does not seem that Drexel was intentionally attempting to mislead SPCC regarding its financial situation.

The fact that Drexel was found to be nonresponsible under a previous solicitation cannot be used to support a finding of lack of integrity, in this case. In the earlier case, Drexel was found to be nonresponsible for financial reasons and not for lack of integrity. Drexel Industries, Inc., B-186840, November 22, 1976, 76-2 CPD 439.

B-189344

While the Navy has stated that Drexel has refused to deliver under the two incomplete contracts, there is no evidence in the record that indicates that Drexel is financially capable of completing the contracts. The SBA's appeal indicates that Drexel has performed to its financial capability under the contracts. Therefore, we do not think that the failure to complete delivery under the contracts is evidence of lack of integrity.

In the facts and circumstances of this case, there is not substantial evidence to support a finding that Drexel was nonresponsible for lack of integrity. Accordingly, the protest is sustained. However, since the determination of nonresponsibility actually involves a matter of financial ability to perform, we recommend that the Navy submit the matter to SBA for consideration for a COC pursuant to ASPR § 1-705.4 (1976 ed.) and, if a COC is issued, consideration be given to terminating the awarded set-aside portion.

By letter of today, we are advising the Secretary of the Navy of our recommendation.

This decision contains a recommendation for corrective action to be taken. Therefore, we are furnishing copies to the Senate Committees on Governmental Affairs and Appropriations and the House Committees on Government Operations and Appropriations in accordance with section 236 of the Legislative Reorganization Act of 1970, 31 U.S.C. § 1176 (1970), which requires the submission of written statements by the agency to the committees concerning the action taken with respect to our recommendation.


Deputy Comptroller General
of the United States