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**DECISION**

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

FILE: B-195183.3 DATE: November 3, 1981

MATTER OF: Serv-Air, Inc.; AVCO -- Air Force Request for Reconsideration

DIGEST:

Where decision to retain function in-house is based on comparison of estimated in-house costs with offers received in competitive procurement, integrity of process dictates that comparison be supported by complete and comprehensive data, and that elements of comparison are clearly identifiable and verifiable.

The Department of the Air Force requests that we reconsider our decision in Serv-Air, Inc.; AVCO, 60 Comp. Gen. 44 (1980), 80-2 CPD 317. The decision involved protests by Serv-Air, Inc. and AVCO Corporation against the Air Force's determination that the Military Aircraft Storage and Disposal Center (MASDC) at Davis-Monthan Air Force Base in Arizona would be operated at a lower cost to the Government through the continued use of Government personnel rather than by awarding a contract based on proposals submitted by either of the two firms.

We sustained the protests to the extent that the Air Force's comparison of in-house costs and the costs of contracting did not comply with the Air Force policy and regulations which the solicitation established as the groundrule for determining whether to contract. Because it appeared that a proper cost comparison would have resulted in an award to Serv-Air and since the first performance year had ended, we recommended that the Secretary of the Air Force consider having a new solicitation issued as soon as possible with a new Government cost comparison made on the basis of offers received in response. That comparison would form the basis for a new Air Force decision with respect to whether to contract the MASDC operation.

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The Air Force now contends that we misread the Air Force cost comparison guideline referenced in the solicitation and that the agency's comparison and decision in fact were consistent with it. We affirm our earlier decision.

Initial Decision

We first pointed out that our review of disputes of this nature is limited to considering whether there was a faulty or misleading cost comparison which materially affected the agency's decision. The reason for this limited role is that agency decisions to perform work in-house rather than by contract involve executive branch policy which we generally do not review as part of our bid protest function. Jets, Inc., 59 Comp. Gen. 263 (1980), 80-1 CPD 152; Crown Laundry and Dry Cleaners, Inc., B-194505, July 18, 1979, 79-2 CPD 38.

We then considered Serv-Air's protest that the Air Force improperly failed to escalate its estimate for civilian personnel costs payable for the second and third years if the MASDC function were retained in-house. The resolution of that issue turned on whether the Air Force cost comparison policy and regulations reflected in chapter 1 of Air Force Manual (AFM) 26-1, "Manpower Utilization," required escalation; we stated that because in preparing their proposals offerors were entitled by the solicitation's terms to rely on AFM 26-1 as the groundrule for the decision on how to continue the MASDC operation, a comparison which did not comply with AFM 26-1 would be "precisely the type of misleading comparison contemplated in our decisions in Jets Inc., supra, and Crown Laundry and Dry Cleaner's, Inc., supra."

We stated:

"We consider that the Air Force's practice here was contrary to the requirement in paragraph 1-18(a) [of AFM 26-1]. * * *

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"We find that paragraph 1-18(a) of AFM 26-1 is dispositive of the matter. The paragraph specifically provides for second and third

> year Government employee pay escalation in the Government estimate when making decisions of the type here in issue if prices are requested for more than one year and there are no economic adjustment clauses. The economic price adjustment clause regarding labor rates for inclusion in contracts is at Defense Acquisition Regulation (DAR) § 7-107 (1976 ed.). It allows for contract price adjustments whenever the contractor's labor costs increase during performance, if otherwise appropriate. This clause did not appear in the RFP.
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> "To the extent that the Air Force views the contract's 'Fair Labor Standards Act and Service Contract Act' clause as the type of economic adjustment clause contemplated by paragraph 1-18(a), that clause only provides for contract price adjustments if the contractor is compelled to increase employees' wages to comply with a change mandated by the Department of Labor. Thus, if a contractor is already paying its employees more than the minimum wage when an increase in the minimum wage becomes operative, there will be no contract price adjustment unless the new wage exceeds the one being paid. Further, offerors certainly may plan to increase proposed personnel costs in years two and three based on business judgment independent of the minimum wage. We do not view the existence of that clause here as invoking the exception to the cost escalation mandate in paragraph 1-18(a)." (Emphasis added.)

We also found that the Air Force's failure to escalate costs "failed to properly give effect to all of the language in paragraph 1-16(e)" of AFM 26-1. Paragraph 1-16(e) requires straight-lining of civilian personnel costs for the three-year

period "unless there are 'known' changes for the second and third year." It further states that:

> "No adjustments will be made in the in-house cost estimate for the second and third year recurring cost items for such things as * * * projected wage increases, except where the contractor has estimated such costs in the second and third year * * *."

We recognized that, as a practical matter, at the time an estimate is prepared there are no "known" changes in the Federal civilian personnel costs for the years after the initial performance year, since historically Federal employee pay increases are not definitized until shortly before the beginning of the fiscal year in which they are to take effect. However, we concluded that the only reasonable reading of paragraph 1-16(e) in light of the direction in paragraph 1-18(a) is that where offers for a fixed-price contract are solicited on a three-year basis without an economic adjustment clause, the in-house estimate must be adjusted for the second and third years.

Request for Reconsideration

The Air Force argues that the economic adjustment clause which was included in the RFP in fact was "an economic price adjustment provision which triggers the exception to the escalation mandate in paragraph 1-18(a) [of AFM 26-1]."

The clause in issue is set out at DAR § 7-1905, which is entitled "Price Adjustment Clauses." It is one of two price adjustment clauses mandated for use in fixed-price service contracts which also contain the clause at DAR § 7-1903.41(a) setting forth compensation and other provisions applicable to contracts over $2,500 subject to the Service Contract Act of 1965. The clauses at DAR § 7-1905 are intended to provide coverage for situations in which revised minimum wage rates are applied to contracts by operation of law, or by revision of a wage determination prior to either the exercise of an option or the extension of a multi-year contract into a new program year.

The Air Force asserts that it is irrelevant that DAR § 7-1905 provides for contract price adjustments only if the contractor is compelled to increase employees' wages to comply with a change mandated by the Department of Labor, which is how we so described the clause in our 1980 decision in finding that it did not invoke the cost escalation exception in paragraph 1-18(a). The Air Force states:

> " * * * It is inaccurate to define an economic adjustment clause in terms of its absolute compensatory value to a contractor compelled to accept changes in cost. No economic adjustment clause employed by the Department of Defense permits contract adjustments to cover all increases in a contractor's labor costs. The clause identified in Serv-Air as the single permissible economic adjustment clause for labor wage rates, DAR § 7-107, expressly limits adjustments to cost increases which exceed three percent of the current contract price, and does not extend to increases in excess of ten percent of the original contract labor rate. By your reasoning, this clause should not qualify as the kind of economic adjustment clause intended in paragraph 1-18(a) because it limits the extent to which contract price adjustments will compensate contractors for their actual personnel cost increases. The impact of DAR § 7-107 * * * is simply to adjust the contract price, within stated limits, for certain specific changes in a contractor's costs. The impact of DAR § 7-1905 is exactly the same, and to exclude it from the coverage of paragraph 1-18(a) suggests the absurd conclusion that since no adjustment clause sanctioned by the DAR permits unlimited recovery of increased personnel costs, the escalation exception could never be invoked."

In this connection, the Air Force suggests that most service contractors estimate their labor costs at rates no higher than those prescribed by the Department of Labor.

Thus, the Air Force suggests that the clause at DAR § 7-1905 "satisfies the clear intent of the paragraph 1-18(a)

escalation exemption -- preventing estimates based on redundant addition of costs covered by an economic adjustment clause."

Discussion

We first note that the Air Force has not addressed our concern that the failure to escalate costs violated paragraph 1-16(e) of AFM 26-1, which in effect requires the escalation of civilian personnel costs to reflect any "known" changes for the three year period. We suggested in our earlier decision that "known" changes contemplated included the reasonably forseeable Federal employee pay increases for the second and third years, so that under paragraph 1-16(e) the Air Force was required to escalate second and third year civilian personnel costs in its estimate.

Even if we were to accept the Air Force position that the DAR 7-1905 clause was contemplated in paragraph 1-18(a) of AFM 26-1 as an economic adjustment clause, paragraph 1-18(a) exempts the Air Force from projecting in its estimate additional pay increases for Government employees for the second and third year only "to the extent that there are no economic adjustment clauses" (emphasis added). The contractor's employees referred to in the price adjustment clause at DAR § 7-1905 are "service employees" covered by the Service Contract Act of 1965 and employees covered by the minimum wage provisions of the Fair Labor Standards Act. The Service Contract Act of 1965 specifically exempts executive, administrative and professional employees, 41 U.S.C. § 357(b), and the minimum wage protection of the Fair Labor Standards Act clearly is not applicable to that classification of employees. Thus, the extent of what the Air Force terms the economic price adjustment clause at DAR § 7-1905 for purposes of paragraph 1-18(a) of AFM 26-1 excludes the contractor's executive-type employees, and an offeror therefore may be considered to have escalated their salaries for the second and third years. It follows that even under the Air Force view on this issue, i.e., that because of the DAR § 7-1905 clause an offeror does not escalate second and third year service employee costs in its proposal, the Air Force should have reasonably escalated second and third year in-house costs for non-service employees where the offerors did.

In the above respect, Serv-Air advises that its offer included 78 executive-type employees with second and third year salary escalation totaling $358,128. The Air Force's three-year estimate to continue the MASDC function in-house was $39,600,000 (91 percent of which reflects civilian personnel costs), while Serv-Air's offer was evaluated at approximately $39,900,000 for three years. While we cannot confirm Serv-Air's advice, we believe that the closeness of the Air Force estimate and Serv-Air's evaluated offer brings the agency's decision not to contract into question even under this analysis.

We find it appropriate at this point to mention two matters which were raised in Serv-Air's protest but which we did not address in view of our conclusion regarding cost escalation: (a) the Air Force's computation of the personnel termination costs if the MASDC function were contracted, and (b) the Air Force's estimated cost for a Project Management Office to, in part, oversee the contractor's performance.

(a) Personnel Termination Costs

Line 6 of the Cost Analysis Worksheet used by the Air Force in its cost comparison is for "Other Costs," defined in paragraph 1-17(f) of AFM 26-1 as "any additional costs which would result from commercial procurement and which are not covered elsewhere." These costs are added to the contract price in comparing it to the in-house estimate. Subparagraph (1) sets out for inclusion in "other costs":

> "An estimate of the termination costs for Government personnel such as premature retirement which causes a significant increase in retirement costs to the Government, severance pay, homeowner's assistance, grade pay retention, and moving/relocation expenses which will be paid solely because a Government in-house activity is discontinued. * * *"

The Air Force Cost Analysis worksheet figure for line 6 was $4,203,284. Serv-Air contended that the total includes termination costs for 66 MASDC positions that would have been vacated by attrition even if the function remained a Government operation. The basis for Serv-Air's contention was that an early comment by the contracting officer in response to a Serv-Air question on the matter appeared to indicate that separation costs for 294 employees, including the 66 positions in issue, were considered

in the cost analysis. Serv-Air argued that the inclusion of the costs was precluded by paragraph 1-17(f)(1) in that they will not be necessitated "solely" because of a decision to contract out.

The Air Force conceded that under the cited guideline termination costs for the 66 positions should not be included in line 6 calculations. The Air Force asserted that despite any initial indication by the contracting officer to the contrary, the 66 positions were not included in severance pay computations.

We (including our auditors) have reviewed the extensive back-up material to the line 6 estimated costs provided by the Air Force, and find that it is not clear on this point. It may well indicate that the first step in computing severance pay costs was the deduction of the 66 positions in issue from the assigned MASDC strength of 655 total, yielding 589 positions, which would be the MASDC strength even if the function were retained in-house, and thus relocation pay, retained pay, and severance pay properly may have been computed based on that figure. However, the back-up data was presented in such a fashion that we could not conclusively determine if that is what occurred.

In our view, where a decision whether to contract for services is based on a comparison of estimated in-house costs with offers received in a competitive procurement, it is important to the integrity of the entire process that the agency making that decision specifically track and identify all elements of the comparison. See Jets, Inc., supra. That was not the case here.

(b) Project Management Office

Line 2 of the Cost Analysis Worksheet is for "Contract Administration and Related Costs" to be added to the contract price. Paragraph 1-17(b) of AFM 26-1 provides that line 2 entries should include "incremental * * * administrative costs which the Government would incur because of the existence of the contract, but which it would not otherwise have to pay. * * *"

The Air Force's three-year total of $4,203,284 included over $1,800,000 for a Project Management Office (PMO) of 29 people the first year, 30 the second and 33 the third. The Air Force described the function of a PMO as one:

> "* * * which must be performed by the Government in order to execute governmental responsibilities such as the management of Government programs requiring value judgments and control of revenue disbursements. The PMO functions include planning, developing, and negotiating Department of Defense workload programs, establishing priorities, and determining reimbursement funds requirements. These functions are distinct from those performed by the Contract Administration Office. * * *"

Serv-Air argued even if the operation were retained in-house the PMO function still would be required, and necessarily would be performed by Government employees. On that basis, Serv-Air contended that the PMO costs will not be incurred "because of the existence of the contract" (paragraph 1-17(b)) and thus should not be included in the cost analysis as a cost of contracting. In fact, Serv-Air pointed out that at the pre-proposal conference the contracting officer did advise offerors that PMO costs would not be reflected in the actual cost comparison.

The Air Force position was that the $1,800,000 added to line 2 basically included three elements: (1) PMO-type costs necessary whether or not the contract was awarded, plus (2) the costs of consolidating the function for a contract operation, plus (3) the costs inherent in the loss of efficiency that the Air Force suggests would result if the in-house operation were terminated. Therefore, as a result of including in the civilian personnel costs of an in-house operation on line 10 ("Civilian Personnel Costs") the costs associated with the portions of "the jobs of a variety of people" that reflect the PMO function, the contracting cost in reality is increased only by the second and third elements noted, i.e., the incremental cost of a contract, as provided for in paragraph 1-17(b) of AFM 26-1.

We recognize that the Air Force's position in this respect -- adding the same cost to both sides of the cost analysis "equation" -- reaches the same result as deleting the PMO-function costs from both lines 2 and 10. However, as stated above, it is our view that these types of decisions must be made on a cost analysis supported by comprehensive and complete documentation. Here, it is our opinion that the Air Force simply had not proffered any substantive evidence to support the alleged impossibility of segregating

the incremental PMO costs and therefore we cannot confirm the propriety of that part of the cost analysis.

Conclusion

As stated at the outset of this decision, the determination whether to contract a function is a matter of Executive branch policy, and our review of bid protests in the area is limited accordingly. Our role includes insuring that where an agency issues a solicitation for the requirement and sets out in the solicitation the groundrule that it will use to make its decision, it follows the groundrule. The reason is that by selecting that approach the agency induces firms to expend the time, effort and money to prepare responses to the solicitation.

The method chosen by the Air Force to decide whether to contract for the MASDC function necessitated a fairly complex cost comparison to be accomplished under policy guidelines which the development of the Serv-Air and AVCO protests suggests are less than entirely clear.* Nonetheless, once the Air Force chose that approach, and the agency's ultimate decision was challenged on a basis that clearly invoked this Office's review, it was incumbent on the agency to support its decision through comprehensive data, with the basic elements clearly identifiable and verifiable. We believe that this especially is the case where, as here, a comparison resulted in a three-year estimate of $39,600,000 to continue the MASDC function in-house, and an offer to perform the function by contract was evaluated at only $300,000, or less than one percent, more.

The Air Force reconsideration request essentially takes issue with our reading of certain parts of AFM 26-1. As we have stated, however, even under the Air Force's reading of the manual the in-house estimate was understated in an amount reflecting escalation for non-service employees for the second and third years of operation, bringing the cost comparison into question. Moreover, as we have indicated in our discussion of the personnel termination and PMO costs that the Air Force included in its estimate for contracting the MASDC function, the Air

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* Office of Management and Budget (OMB) Circular A-76, "Policies for Acquiring Commercial or Industrial Products and Services Needed by the Government" sets guidelines that have replaced those in AFM 26-1.

Force response to the protests on these matters did not support the cost comparison. The response essentially involved only submission of the cost analysis worksheet and a considerable amount of raw material purporting to support the elements that went into the worksheet entries. However, we simply are unable to conclude that the material reasonably supports the Air Force's statements.

We remain of the view that the Secretary of the Air Force should consider having a new solicitation issued with a new Government cost comparison made on the basis of the offers received in response. That comparison would follow the guidelines in OMB Circular A-76 and its accompanying instructions, which now apply to all executive branch agencies.

Our prior decision is affirmed.

for Milton J. Socolar
Comptroller General
of the United States