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The Comptroller General
of the United States

Washington, D.C. 20548

Decision

Matter of: Nebraska Aluminum Castings, Inc.--Reconsideration

File: B-222476.2

Date: September 23, 1986

DIGEST

Prior decision upholding an agency's rejection of a bid as materially unbalanced is affirmed as the General Accounting Office (GAO) sees no basis upon which to alter its conclusion that the protester's first article bid price was grossly inflated because of the firm's failure properly to allocate its equipment and tooling costs over the entire life of the contemplated contract.

DECISION

Nebraska Aluminum Castings, Inc. (NAC), requests reconsideration of our decision in Nebraska Aluminum Castings, Inc., B-222476, June 24, 1986, 86-1 CPD ¶ 582. We concluded that the Department of the Army had properly rejected NAC's bid under invitation for bids (IFB) No. DAAK01-85-B-B060 as materially unbalanced where the firm had charged a first article unit price which was grossly inflated. We reached this result in view of our decisions in Edgewater Machine & Fabricators, Inc., B-219828, Dec. 5, 1985, 65 Comp. Gen. ___, 85-2 CPD ¶ 630 and Riverport Industries, Inc., 64 Comp. Gen. 441 (1985), 85-1 CPD ¶ 364, aff'd upon reconsideration, B-218656.2, July 31, 1985, 85-2 CPD ¶ 108, which established the rule that a bidding scheme which grossly front-loads first article prices as a device to obtain unauthorized contract financing renders the bid materially unbalanced *per se* so as to require its rejection as nonresponsive. The rationale for this rule is that an award to a firm submitting greatly enhanced first article prices will provide funds to the firm early in the period of contract performance to which it is simply not entitled if payment is to be measured on the basis of actual value received. Edgewater Machine & Fabricators, Inc., B-219828, supra, 65 Comp. Gen. at ____, 85-2 CPD ¶ 630 at 4.

As noted in our June 24 decision, NAC was the low remaining bidder under the IFB, which sought the acquisition of unmounted magnetic compasses for field use, with a price of $225,100 for 10 first articles and $1,917,038 for 100,002 production items. NAC's first article price represented 10.5 of its total bid price, and, significantly, the first article unit price of $22,510 was more than 1,000 times greater than the production item unit price of $19.17. We agreed with the Army that this constituted a materially unbalanced bidding scheme under Riverport and Edgewater. We saw no legitimate reason why NAC should have submitted a greatly enhanced price for the first articles. From NAC's own cost figures, we determined that the firm's first article price was disproportionate to the actual value of those 10 units in large part because NAC had sought to recapture most of its costs for special equipment and tooling during the first article testing and acceptance period--although it was clear from the record that most of that equipment would be utilized for the manufacture of the production items as well as the first articles. Thus, the front-loading of such capital expenditures into the first article period had materially unbalanced the firm's bid since those costs should have been properly allocated over the total contract period. Accordingly, we upheld the Army's rejection of the bid as nonresponsive.

NAC now requests reconsideration of our prior decision on the principal grounds that (1) we erred in concluding that NAC's bid was materially unbalanced because the firm had failed to amortize its special equipment and tooling costs and (2) it was unfair to retroactively apply the Riverport and Edgewater rule solely to NAC's bid in the instant case as the firm had no notice of its applicability. NAC contends that the other bids, including that of Stocker & Yale, Inc., the incumbent, should also be found to be unbalanced under the Riverport and Edgewater rule. Accordingly, NAC argues that we should reverse our prior decision to find that the firm's bid was responsive as submitted, or, in the alternative, to direct the Army to cancel the present IFB and resolicit the requirement under a new solicitation which provides specific guidance with regard to what constitutes an acceptable first article/production item unit price ratio so as to enable bidders to prepare and submit balanced bids.

We affirm our prior decision.

NAC asserts that our conclusion that the firm had improperly front-loaded its special equipment and tooling costs into the first article period contradicts earlier decisions of this Office in which we have held that start-up costs properly may be recovered early in the total contract period. NAC refers to our decision in Jimmy's Appliance, 61 Comp. Gen. 444 (1982), 82-1 CPD ¶ 542, a case involving a bid allegedly unbalanced as to base year and option year prices, in which we noted that the contracting agency had found that the higher base year bid price "properly reflected its proportional share of the cost of the total contract, since it included equipment and setup costs." NAC apparently believes this case represents the settled view of this Office that start-up costs for equipment and tooling necessary to perform a contract may be allocated to the initial period of performance, thus legitmately resulting in higher prices for that element of the total bid. We find Jimmy's Appliance to be inapposite to the facts of this case.

The question of start-up costs has involved cases where a bid is allegedly unbalanced with regard to the price differentials between base and option years. Our view on this issue is that a bidder may properly allocate equipment costs to the base period of performance only where it would have no use for the equipment after the contemplated contract ends, since, if these costs were allocated throughout the potential life of the contract and the options were not exercised, the bidder would never be able to recover its full costs of performance. Applicators, Inc., B-215035, June 21, 1984, 84-1 CPD ¶ 656; Roan Corp., B-211228, Jan. 25, 1984, 84-1 CPD ¶ 116. This case, in contrast, involves firm production quantities with start-up costs properly allocable to the entire production. In other words, the risk associated with the non-exercise of an option does not exist in the award of a fully funded production contract. Where first article approval is required, it is the contractor, not the government, that must normally bear the risk until first article approval is obtained. Federal Acquisition Regulation, 48 C.F.R. § 9.305 (1985).

Our June 24 decision also did not conclude that the actual value of its first articles was no greater than the $19.17 the firm bid for the production items, as NAC asserts. Although greatly disproportionate prices between the first articles and the production items--such as the 1,000 percent differential at issue here--indicate that a bid is materially unbalanced under Riverport and Edgewater, the final test is not the degree to which the first article unit price exceeds the production item unit price, but rather the extent to which the prices charged for the first articles bear no reasonable relation to the costs actually associated with the production and testing of those units.

We have carefully reexamined the entire record, and we remain of the opinion that NAC's first article price was grossly inflated because of the firm's failure properly to allocate its equipment and tooling costs over the entire life of the contract. Therefore, we see no basis upon which to alter our prior conclusion that the firm's bid was materially unbalanced under the Riverport and Edgewater rule. See Department of Labor--Reconsideration, B-214564.2, Jan. 3, 1985, 85-1 CPD ¶ 13.

NAC contends that it was unfair for the Army to apply that rule retroactively to cause the rejection of its bid. We addressed that argument in our June 24 decision, noting that the Riverport and Edgewater decisions had been issued some time ago and, therefore, were legally controlling in the matter, and that the Army could not be faulted for acting upon the recommendations made in them that steps be taken to discourage this type of bidding. The Army has advised this Office that it is now incorporating a specific provision into solicitations contemplating first articles which cautions bidders and offerors that prices for their first article units "should reflect only reasonable costs associated with producing and testing those units or run the risk of being rejected as unacceptable if the bid/offer is found to be materially unbalanced."1/

We recognize that the bid of Stocker & Yale, the incumbent contractor and the firm next in line for award, reveals a first article unit price of $1,222.41, which, although relatively much lower in price than the first article prices of the other bidders, is nonetheless 55 times greater than the firm's production item unit price of $21.97. We presume that the firm, after 10 years as the incumbent, has no significant costs associated with producing and testing the first articles.

However, this fact does not persuade us that Stocker & Yale's bid necessarily should be rejected and the procurement recompeted, as urged by NAC. Although Stocker & Yale's bid

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1/ We note that NAC has protested this language as being vague and undefined as contained in a new invitation for an additional number of compasses. That protest will be decided at a later date.

may indicate a certain degree of unbalancing, the Riverport and Edgewater rule is essentially inapplicable with regard to the responsiveness of the bid since we assume that the Army would award the firm the contract without requiring first articles.2/

Our prior decision is affirmed.

for Milton J. Socolar
Comptroller General
of the United States

2/ The IFB permitted the submission of alternate bids to be applied in the event first article testing were waived. Only Stocker & Yale submitted an alternate bid.