Comptroller General
of the United States

Washington, D.C. 20548

Decision

Matter of: Smelkinson Sysco Food Services

File: B-281631

Date: March 15, 1999

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DIGEST

Protest of terms of solicitation for commercial food distribution services is sustained where agency failed to conduct adequate market research to support its determination that the challenged terms (requiring, among other things, that profit associated with interorganizational transfers of food items be disclosed) are consistent with customary commercial practice, or, alternatively, failed to obtain waiver necessary to tailor standard commercial item provision in a manner inconsistent with customary commercial practice.

DECISION

Smelkinson Sysco Food Services protests the terms of request for proposals (RFP) No. SPO300-99-R-D008, issued by the Defense Supply Center Philadelphia (DSCP), Defense Logistics Agency, for full service food distribution support for a number of federal installations in the Washington D.C. area. Smelkinson protests the RFP requirement that offerors disclose, among other things, profit associated with interorganizational transfers of food items.

We sustain the protest.

The RFP, issued on October 23, 1998, contemplates the award of a fixed-price contract with weekly economic price adjustments, for a base year and 4 option years, for full line food distribution, where the "prime vendor" contractor serves as the customer's primary source for food items. The procurement is being conducted pursuant to the commercial-item acquisition procedures of Part 12 of the Federal Acquisition Regulation (FAR). The RFP's pricing schedule lists commercial food items to be supplied, with their estimated quantities, for offerors to price. Offerors are to provide the following prices by item: delivered price per unit, distribution price per unit, total unit price, and total extended price. The RFP's "price changes" clause, included in the solicitation as an addendum to FAR § 52.212-4, provides the

following definitions of the relevant pricing terms: the "unit price" is the "total price charged to DSCP per unit for a product delivered to the Government consisting of two components: 'delivered price' and 'distribution price'"; the "delivered price" is the "actual invoice price . . . of the product paid to the manufacturer/supplier, delivered to the Prime Vendor's facility"; and the "distribution price" is the "firm fixed price, offered as a dollar amount, which represents all the elements of the contract price other than the delivered price . . . [such as] projected general and administrative costs, overhead, profit, packaging costs, transportation costs . . . and any other expenses." RFP § 52.212-4(t), at 82-83. This clause allows for changes in the "delivered price" on a weekly basis, to reflect fluctuation of item prices in the commercial market; the contractor's distribution price, however, remains fixed.

The RFP's "interorganizational transfers" clause, the subject of this protest, provides further pricing requirements for the determination of "delivered price" related to transfers among contractor affiliates or divisions. This clause provides as follows:

> For purposes of determining the delivered price of an item delivered under this contract, allowances for materials, supplies and services that are sold or transferred between any divisions, subdivisions, subsidiaries, or affiliates of the contractor under a common control shall be on the basis of the cost incurred by the transferring organization. When materials or supplies are purchased specifically for the contract, only the actual purchase cost of these materials or supplies should be charged to the contract. . . .
>
> If the contractor has an established centralized procurement function, all actual costs associated with the operation of this function may be added to the invoice price when the product is transferred to the affiliated organization.
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> Notwithstanding the above, allowances may be at price when it is an established practice of the offeror/contractor to transfer product to its affiliated organizations at other than actual cost, by use of a catalogue, competition or some other standard pricing mechanism, that transfer price can be used as the invoice price of the item as long as all affiliated organizations were charged the same price for that item.
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> <u>If the catalogue or standard price at which the item is being transferred includes profit to the transferring organization, that profit must be disclosed to the Contracting Officer</u>. The Contracting Officer and the offeror/contractor will agree to a procedure for this disclosure. <u>If no disclosure is made, then profit may not be included in the price charged to the Government for the item</u>.

RFP § 52.212-4(u), at 84-85 (emphasis added).

The same RFP clause addresses freight (or transportation) costs as follows:

> The following requirements must be met before freight costs can be charged to the Government as part of the delivered price of the product:
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> 1. Only actual costs paid by the contractor or any of its affiliated organizations may be included as part of the delivered price.
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> . . . . .
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> 4. If the offeror/contractor deviates from the above, full disclosure must be made to the Contracting Officer who will determine if an exemption from these requirements will be granted. Exemptions will only be granted when the Contracting Officer determines that the exemption is in the best interest of the Government.

Id. at 85-86 (emphasis added).

Smelkinson contends that the requirements for disclosure of profit and freight costs in excess of actual costs related to interorganizational transfers among affiliates are contrary to customary practice in the food distribution industry.

Smelkinson asserts that it is customary in the food service industry for large food distributors, or consortiums of smaller food service companies, to operate through a central purchasing and distribution center that can purchase from suppliers at high volume, resulting in lower prices that may be passed to consortium members or affiliates. Smelkinson explains that certain mark-ups may then be added to these prices, for instance, in light of numerous "value-added services" performed by the central purchasing and distribution center for its members. Smelkinson Comments, Jan. 14, 1999, at 4-7. Smelkinson further states that where the distributor, or central purchasing and distribution center, operates its own transportation network, customary commercial practice is for transportation of the item transferred to be charged at price, rather than cost, which may include profit or other elements.

Smelkinson contends that, although different food service distributors may price their products and product transfers in different ways, it is not customary practice to require, as the RFP does here, disclosure of profit, or freight costs in excess of actual costs, in otherwise competitive prices offered by the distributors. Smelkinson adds that its large commercial food distribution operation does not include an accounting system that identifies the "profit" element per interorganizational transfer required to be disclosed by the RFP. Smelkinson therefore contends that, since the challenged disclosure terms are inconsistent with customary commercial practice, and, since the agency has failed to request and obtain the waiver necessary to include the challenged terms, the RFP is defective.

FAR § 12.301(a), implementing the Federal Acquisition Streamlining Act (FASA) of 1994, 10 U.S.C. § 2377 (1994), regarding the preference for the acquisition of commercial items that meet an agency's needs,[1] provides that

> contracts for the acquisition of commercial items shall, to the maximum extent practicable, include only those clauses--
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> (1) Required to implement provisions of law or executive orders applicable to the acquisition of commercial items; or
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> (2) Determined to be consistent with customary practice.

FAR § 12.301(b)(3) provides for the inclusion of the clause at FAR § 52.212-4 in solicitations and contracts for commercial item acquisitions, which clause "includes terms and conditions which are, to the maximum extent practicable, consistent with customary commercial practices." FAR § 12.301(b)(3) further provides that the "contracting officer may tailor" the terms of FAR § 52.212-4 in accordance with FAR § 12.302. In pertinent part, FAR § 12.302(a), provides that:

> because of the broad range of commercial items acquired by the Government, variations in commercial practices, and the relative volume of the Government's acquisitions in the specific market, contracting officers may, within the limitations of this subpart, and after conducting appropriate market research, tailor the provision at . . . [FAR §] 52.212-4, Contract Terms and Conditions--Commercial Items, to adapt to the market conditions for each acquisition.

FAR § 12.302(c), regarding the tailoring of clauses for conditions inconsistent with customary practice, provides:

> The contracting officer shall not tailor any clause or otherwise include any additional terms or conditions in a solicitation or contract for commercial items in a manner that is inconsistent with customary commercial practice for the item being acquired unless a waiver is approved in accordance with agency procedures. The request for waiver must describe the customary commercial practice found in the marketplace, support the need to include a term or condition that is inconsistent with that practice and include a determination that use of

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[1]In determining whether commercial items are suitable to meet an agency's needs, FASA requires that the head of an agency conduct market research "appropriate to the circumstances . . . before developing new specifications for a procurement by the agency; and before soliciting bids or proposals for a contract in excess of the simplified acquisition threshold." 10 U.S.C. § 2377(c).

> the customary commercial practice is inconsistent with the needs of the Government. A waiver may be requested for an individual or class of contracts for that specific item.

In response to the protest here, the agency asserts that the interorganizational transfers clause included in the RFP, as an addendum to FAR § 52.212-4, is not inconsistent with customary commercial practice in the food distribution industry, and therefore no waiver is required to tailor the clause. The agency states that it has conducted market research that supports its position; in particular, the agency lists several conferences held in the food distribution industry in which the agency discussed its prime vendor program. Some of the solicitations recently issued pursuant to this program include the currently protested terms. The agency reports that no other firm has objected to the terms of the interorganizational transfers clause at these conferences. Consequently, the agency asserts that, since no single pricing method is utilized in the food services distribution industry, and no firm has objected to the clause's terms (even though they were included in other recent prime vendor solicitations), the clause is not inconsistent with customary commercial practice. The agency does not assert, however, nor does the record otherwise show, that the specific terms challenged by Smelkinson were ever researched or discussed by the agency with industry representatives at these conferences or elsewhere.

The FAR, at Part 10, provides general guidance to an agency regarding the scope and proper methods for conducting required market research. The specific techniques listed and factors to be considered, see FAR § 10.002(b)(1), reflect the purpose of market research--to generate a meaningful exchange of information between the agency and industry. Here, we think that the agency has failed to meet its obligation to conduct appropriate market research to show that the challenged terms are consistent with customary commercial practice.

As stated above, there is no showing in the record that the specific disclosure requirements, particularly regarding profit, were ever researched, discussed with, or commented upon by, industry representatives.[2] While the agency relies on the fact

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[2]The agency states that in Lankford-Sysco Food Servs., Inc.; Sysco Food Servs. of Arizona, Inc., B-274781, B-275081, Jan. 6, 1997, 97-1 CPD ¶ 11 at 5, we found the same market research claimed here by the agency to be appropriate support for the agency's determination in that case that a different clause in a prime vendor solicitation, regarding rebates and discounts, was reflective of customary commercial practice. In that case, however, the agency reported that comments had been solicited and received from industry representatives, supporting the customary nature of the particular clause at issue in that case. Id. Here, however, the record provides no evidence that the disclosure requirements of the RFP's

(continued...)

that the clause at issue was not objected to by industry representatives, such silence alone is not an acceptable substitute for the agency's obligation to conduct market research to confirm customary industry practice in the use of these terms, particularly in view of the protester's assertion that there is no industry practice requiring disclosure of profit or other cost data for interorganizational transfers.[3] In fact, the agency itself acknowledges that there is no customary commercial practice requiring such disclosure. DSCP Supp. Report, Jan. 28, 1999, at 3; Affidavit of Thomas J. Lydon, Jan. 28, 1999, at 1-2.

Since the clause at FAR § 52.212-4, presenting standard terms and conditions for use in commercial item acquisitions, does not include the disclosure requirements challenged by Smelkinson, it is clear that the agency has "tailored" the provision in the RFP. Given the lack of any meaningful market research showing that the challenged terms are consistent with customary commercial practice, we conclude that the agency violated the requirement in FAR § 12.302(a) to conduct appropriate market research prior to tailoring the regulatory provision. In the alternative, given the agency's apparent concession that there is no customary commercial practice calling for the type of disclosure required by the RFP clause, we conclude that the agency improperly tailored the standard clause at FAR § 52.212-4 without obtaining the requisite waiver to do so under FAR § 12.302(c). Accordingly, we sustain the protest.[4]

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[2](...continued)
interorganizational transfers clause were ever the subject of discussions with industry representatives.

[3]The protester's position is based on a sworn statement by one of its vice presidents who states that he is familiar not only with the protester's own practice, but with the practices of other food service companies and several purchasing consortiums of such companies. Declaration of Dale K. Robertson, Jan. 13, 1999, at 1,3.

[4]The protester also contends that the agency developed its price disclosure requirements to target the protester. Since there has been no showing, nor do we find evidence in the record, of agency intent to harm the protester in this regard, we find no merit to the allegation. See Virginia Telecomms. & Sec., Inc., B-247368, May 20, 1992, 92-1 CPD ¶ 456 at 4. The protester also argues that the requirements for disclosure of profit and freight costs in excess of actual costs on interorganizational transfers are contrary to the prohibition on requiring certified cost and pricing data in a commercial item acquisition. See FAR § 15.403-1(b)(3). While we agree that requiring submission of cost or pricing data would generally be inappropriate in the context of a commercial-item acquisition, the prohibition to which the protester refers applies to certified cost or pricing data, see FAR §§ 15.401, 15.406-2, and the RFP clause at issue here contains no requirement for such certification.

We recommend that the agency amend the RFP to remove the challenged disclosure provisions, and then request new proposals. In the alternative, if the agency continues to believe that the provisions are needed, the agency should either confirm through appropriate market research that the provisions are consistent with customary commercial practice or obtain a waiver, pursuant to FAR § 12.302(c).[5] We also recommend that the protester be reimbursed the reasonable cost of filing and pursuing its protest, including attorneys' fees. 4 C.F.R. § 21.8(d)(1) (1998). The protester should submit its claim for costs, detailing and certifying the time expended and costs incurred, with the contracting agency within 60 days after receipt of this decision. 4 C.F.R. § 21.8(f)(1).

The protest is sustained.

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[5]The agency asserts that the challenged clause is necessary for it to conduct a proper price analysis of proposals and to prevent overcharges by the contractor for adjustments to the delivered price. We find this issue premature for our review at this time. Any examination of the agency's need for the clause would not be ripe for review until the agency obtained a waiver to tailor the standard commercial item provision at FAR § 52.212-4. The agency's statement of need for the clause would be generated during the waiver process pursuant to FAR § 12.302(c). See Aalco Forwarding, Inc., et al., B-277241.8, B-277241.9, Oct. 21, 1997, 97-2 CPD ¶ 110 at 18-22.