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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

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LOGISTICS AND COMMUNICATIONS
DIVISION

MAY 29 1973

B-145455

The Honorable
The Secretary of Defense



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Dear Mr. Secretary:

We have monitored the Military Sealift Command's (MSC's) negotiation and administration of contracts with Sea-Land Service, Inc., which were in effect during the period from 1966 through 1973. These contracts--MST-SC-182(x), SA-1029, CA-1380, and CA-1580--were negotiated primarily for the transportation of containerized military cargo from the west coast of the United States to Okinawa, the Philippines, and Vietnam.

MSC paid Sea-Land about \$278 million for service under the first three contracts. The current contract, 1580, became effective on July 1, 1971, and will remain in effect until June 30, 1973. Sea-Land received approximately \$36.4 million during the first year of this contract.

We monitored MSC's procurement of contract container service because of the increased use of containers for transporting commercial cargo and because of the potential long-range effects of the Government's initial contracting efforts in the container transportation field.

Information gathered during our study indicated that the container method of shipping resulted in significant operational and cost advantages to the Government. For example, the Joint Logistics Review Board, which was established by the Department of Defense, found that port congestion in the ocean pipeline to Vietnam was relieved and that maximum use of containerization in support of Vietnam could have saved in excess of \$800 million during the period 1965 through 1968. The Board also found that containerization reduced cargo damage and pilferage.

However, MSC could have added to these advantages by improving its negotiating practices and by strengthening its administrative procedures. Our primary concern is that the

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contracts were awarded without reasonable assurance that the prices offered by the contractor were fair. The improvement opportunities available to MSC in the negotiation and administration of contracts 182, 1029, and 1380 were discussed at length in a report which we sent to you in August 1970; therefore, we will mention them only briefly in this report.

Although MSC improved its negotiating procedures in awarding the current contract--1580--a noncompetitive situation occurred when one of the two bidders withdrew. As a result, the contract was awarded to Sea-Land at a price which MSC had to accept because the service was essential to meet Southeast Asia logistic support activities and no other source was available.

INITIAL CONTAINER SERVICE TO OKINAWA
AND THE PHILIPPINES--CONTRACT 182

After observing the port conditions in Okinawa, the Philippines, and Vietnam in 1965, the Under Secretary of the Navy directed MSC to solicit ocean carriers for suitable containership service to Okinawa. These solicitations brought responses from several carriers, but MSC determined that only Sea-Land could provide the required containership service to Okinawa.

MSC also determined that, since proposals had been received from more than one carrier, adequate price competition existed and did not request cost or pricing data in support of Sea-Land's prices. In May 1966 MSC awarded contract 182 to Sea-Land.

In addition to paying for transporting cargo under this contract, MSC also agreed to pay Sea-Land \$375,000 for positioning three of its ships and \$1.4 million for positioning containers and chassis at Oakland and Seattle to begin the service. Prices for positioning this equipment were established after other carriers had been eliminated from competition. However, MSC did not obtain certified cost or pricing data supporting the price of these amendments.

On January 20, 1967, contract 182 was amended to include containership service to the Philippines. One provision of the amendment authorizes payment for positioning equipment and vessels at a specified rate per container, not to exceed the contractor's actual cost. Under this amendment, MSC subsequently paid Sea-Land \$339,744 without obtaining information on what actual positioning costs Sea-Land had incurred.

INITIAL CONTAINER SERVICE TO
VIETNAM--CONTRACT 1029

In March 1967 MSC negotiated Shipping Agreement 1029 with Sea-Land for container service to Vietnam. MSC sent requests for proposals to 460 prospective respondents. Of the seven responses received, five were eliminated because they were not considered responsive to all of DOD's requirements.

MSC found that, when compared with the remaining offer, Sea-Land's proposal offered the Government a superior service with an earlier starting date and without minimum cargo guarantees and price escalation. Sea-Land was therefore awarded the contract without being required to support its price with certified cost or pricing data.

CONTINUED SERVICE TO VIETNAM--
CONTRACT 1380

In July 1969 MSC negotiated Container Agreement 1380 with Sea-Land to continue containership service to Vietnam. MSC sent requests for proposals to 36 prospective respondents, but Sea-Land was the only respondent. MSC informed Sea-Land that, to satisfy the requirements of the Armed Services Procurement Regulation (ASPR), certified cost or pricing data would be required. Although protesting this requirement, Sea-Land eventually did submit cost data to support its proposal.

When cost or pricing data is obtained, as it was in this case, ASPR 3-809(b)(1) required that the contracting officer request an audit review of such data by the appropriate contract audit activity. Contracting officers may waive this requirement when it is clear that the data is adequate. If the audit is waived, the contract file must be documented to show the reasons for such waiver. In this case, the contracting officer did not request a preaward audit of the data, nor did he document the contract file to show why he had waived the audit.

In our earlier draft report, we suggested that MSC strengthen its negotiating and administrative procedures as follows.

- More clearly determine whether adequate competition exists in negotiating container contracts.
- Obtain cost or pricing data sufficient to evaluate the reasonableness of contract prices when adequate competition is nonexistent.

- More effectively utilize the professional services of the Defense Contract Audit Agency (DCAA) in determining the reasonableness of contract prices to be negotiated.
- Request DCAA to perform a postaward audit of contract 1380 to ascertain whether the data submitted was accurate, current, and complete.
- Discuss with Sea-Land the cost basis of positioning charges under contract 182 and, if such charges are determined to be excessive, attempt to obtain an adjustment.
- Make a more intensive and critical review of the propriety of the bills submitted to its subordinate commands.
- Require its Internal Review Group to make more frequent reviews of those activities responsible for contract administration.

In responding to our proposals the Department of the Navy said that, in accordance with ASPR 3-807.1, determining the adequacy of price competition is a matter of judgment and that MSC believed that a competitive environment had been created and that adequate price competition existed for contracts 182 and 1029.

The Navy said that, for contract 1380, the data available was more detailed and extensive than that for the two previous contracts and that the cost data furnished by Sea-Land had been judged in light of other available data. Thus, MSC believed that the cumulative data was sufficient to proceed with negotiations without referring the matter to DCAA. The Navy also doubted that a postaward review would yield useful results.

The positioning charges mentioned in our fifth suggestion above included \$1,658,462 for positioning vessels and equipment for the Okinawa service. The Navy said that Sea-Land and MSC were negotiating this matter and that we would be advised of the outcome of the negotiations.

The Navy also informed us that, as a result of our review, MSC's contract administration procedures were tightened by requiring more extensive examinations of documents supporting contractors' invoices. However, due to limited personnel and an austere funding climate, the MSC's Internal Review Group could conduct only limited reviews.

NEGOTIATIONS OF THE CURRENT CONTAINER
CONTRACT--1580

In December 1970 MSC decided to continue providing container service to Vietnam. In January 1971 it sent out request for proposals (RFP-601) with instructions that carriers respond by March 1. MSC received responses from only two carriers, Sea-Land and United States Lines, Inc. MSC requested--and the carriers agreed--that their offers be kept open until May 15 to (1) allow time for DCAA to audit the cost and pricing data requested from Sea-Land and (2) enable United States Lines to revise its proposal (the Contracting Officer had ruled that it was not responsive in several areas).

Sea-Land submitted its cost data on April 2. On the same date MSC asked DCAA to audit the data. In the meantime MSC advised United States Lines that its offer would expire on May 15 unless a response was received. United States Lines did not respond, which placed MSC in a sole-source procurement situation.

On May 20, 1971, DCAA issued a report to MSC on its evaluation of the reasonableness and accuracy of Sea-Land's cost estimate. DCAA reported that it did not consider the contractor's cost or pricing data adequate under Public Law 87-653. Specific reference was made to the contractor's lack of support documentation for various elements of costs proposed. Nevertheless, DCAA considered the cost or pricing data as submitted by Sea-Land to be acceptable as a basis for negotiation but questioned a total of about \$11.2 million included in the contractor's cost estimate.

The cost data questioned by DCAA and considered unallowable was summarized by MSC for negotiation purposes as follows:

	<u>Amount</u>
	(millions)
Unallowable by statute	\$ 6.1
" " interpretation	3.2
" " judgment	<u>1.9</u>
Total	<u>\$11.2</u>

Using the \$11.2 million of questionable costs as a bargaining point, MSC vigorously attempted to negotiate a lower price with Sea-Land. MSC contended that many of the costs questioned by DCAA were unallowable under ASPR and that, therefore, the rates offered by Sea-Land were excessive. Sea-Land's

position was that, regardless of the DCAA audit and the associated unallowable costs, the rates offered represented the required revenue to sustain the service to be provided by Sea-Land.

A MSC memorandum commenting on the negotiations at this point stated that the Government representatives did not believe that Sea-Land's price was fair but that it was the best rate obtainable under the circumstances.

The memorandum indicated that the Government's contracting officials reached this conclusion because (1) container service was needed to effectively and efficiently support the war effort and the Vietnamization program and (2) there were no other commercial carriers that individually or collectively could come forth and fill the void by July 1, 1971, should MSC not accept Sea-Land's offer.

Conclusions and recommendations

MSC has strengthened and improved its negotiating practices by obtaining cost and pricing data and utilizing the audit services of DCAA. MSC personnel have zealously attempted to obtain more equitable rates from Sea-Land on the current contract. However, since Sea-Land was in a strong sole-source position and MSC needed the services, little margin remained for meaningful negotiations.

We understand that, as a result of withdrawal of the U.S. forces from Vietnam, Sea-Land's contract will not be renewed when it terminates on June 30, 1973. Therefore we are discontinuing our monitoring of these contracts.

However, the Department of Defense is increasingly reliant on container service and the direct delivery concept associated with it. The Department's planning efforts should now be directed to insuring that it will not be without alternatives should it be confronted with a contractor that insists on a price that the Department feels is unreasonable.

We have not studied the possible alternatives which might satisfy the transportation needs of the type required in Southeast Asia so we cannot endorse a specific solution at this time. However, we believe that, in developing its future options, the Department of Defense should consider:

- Encouraging the development of competitive common carrier service.

--Establishing standby agreements that carriers will furnish services at fair prices during periods of emergency or unusual requirements as a condition precedent to participation in peace-time traffic.

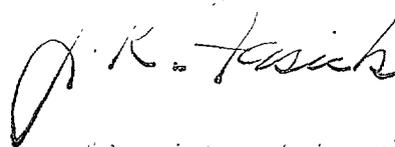
--Combining in-house and commercial service to achieve a competitive climate.

We would like to be informed of the outcome of MSC's negotiations with Sea-Land on the charges paid under contract 182 for positioning vessels and equipment.

We are sending copies of this report to the Secretaries of the Army, Navy, and Air Force; to the Commander, Military Sealift Command; and to the Chairman, Renegotiation Board.

We appreciate the cooperation we received from the Department of Defense during our review, and we will be glad to further discuss our findings with you or other Department officials.

Sincerely yours,



~~J. K. Fasick~~
J. K. Fasick
Director