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

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FILE: B-191949 DATE: October 27, 1978

MATTER OF: KET, Incorporated

DIGEST:

1. Rule that GAO will not question under bid protest procedures manner of exercise of option applies only to protest filed by incumbent contractor complaining that option in its contract should have been exercised. Protest by firm interested in competing for requirement covered by contract option will be considered.

2. Where purchase option price was not evaluated in awarding initial contract but added by subsequent contract modification, procedures followed in exercising purchase option should comport as much as possible with competitive procurement norm. Interested suppliers should be afforded adequate notice and fair opportunity to have products and prices evaluated and normally this should be accomplished through competitive procurement.

3. Procedures established for potential suppliers to demonstrate equipment were unduly restrictive because agency made no apparent effort either to examine whether acceptability of equipment could be established through simulation testing techniques as requested by protester or to attempt to provide access to Government equipment to facilitate testing. GAO recommends that protester be permitted to show acceptability of equipment, particularly in view of alleged successful performance of recent similar contract with other agency.

KET, Incorporated protests the issuance and terms of a notice issued by the Internal Revenue Service (IPS) and published in the Commerce Business Daily (CBD) seeking firms willing to perform a demonstration test of plug-to-plug memory equipment compatible with central processing units (CPU) in operation at the IRS.

The May 3, 1978, CBD notice read as follows:

"70--MEMORY, compatible with Control Data Corporation (CDC) 3500 CPU, [in accordance with] the following requirements:

"1. Proposed memory must be plug-to-plug compatible with existing CDC 3500 CPU's. No software or hardware changes, however minor, will be allowed.

"2. Proposed memory must be demonstrated at a site other than the IRS by 1 Jul 78, and the demonstration test must be conducted on a CDC Model 3514-4 CPU. The Government shall be provided sufficient documentation on the program(s) (e.g., source listings) to determine the validity of the demonstration test. Further, offerors shall provide copies of the program(s) to the Government for the purpose of conducting a 'head-to-head' test between the respondent's memory and the existing CDC memory.

"3. Respondents * * * will be required to develop test program(s) which * * * produce hardcopy output which will enable the Government to determine memory timing/throughput rates.

* * * * *

"The request is for information and planning purposes only. The Government does not intend to award a contract on the basis of this request, nor will the Government pay for information provided in response to this request."

This matter is the subject of a suit filed by KET in the Federal District Court for the District of Columbia, in which KET seeks to enjoin the IRS from awarding any contract for or exercising existing options to purchase CDC 3500 memory except upon the basis of a fully competitive solicitation for such memory. A temporary restraining order, preventing the Government from proceeding in this matter before October 30, 1978, or until the matter could be earlier considered, was issued

by the United States Court of Appeals for the District of Columbia. The case is for consideration under § 20.10 of our Bid Protest Procedures, upon requests for our opinion by both the District Court and Court of Appeals. See, e.g., Dominion Engineering Works, Ltd., et al., B-186543, October 8, 1976, 76-2 CPD 324.

By way of background we note that KET previously protested sole source procurement from CDC for various equipments but has been frustrated in its attempts to compete for IRS's requirements. In denying a prior protest by KET we took special note of IRS's advice "that it is making every reasonable effort to minimize the competitive advantage which CDC may enjoy on the follow-on solicitation." We have assumed that the above CBD notice is in furtherance of that advice even though the request was for information and planning purposes.

As we view the CBD Notice, the IRS required only a general demonstration of capability. It did not delineate specific tests to be performed. Moreover, the test programs were to be written by the manufacturer. Any test would have sufficed, provided it was reasonably adequate to validate the various functions performed by the proposed replacement memory and provided it permitted the IRS to determine timing and throughput rates from the resulting hardcopy data. Copies of the programs and related documentation were to be provided to permit the IRS to generate comparable data using its existing Control Data memory, for purposes of comparison.

Until this case came on for hearing in the District Court on KET's motion for a temporary retraining order, KET believed, and maintained before our Office, that the IRS's purpose in conducting the demonstration for information and planning was misleading and that, in fact, the Notice of Demonstration was contrived as a means of assuring that a new contract be awarded to Control Data on a sole-source basis. In addition to challenging the demonstration procedure adopted by the IRS as amounting to improper prequalification, KET argued that in the unusual circumstances presented here the IRS should have facilitated the demonstration by allowing it to demonstrate the acceptability of its product through simulation, or by making available one of the CDC 3500's in use at the IRS.

KET states that it is the leading third-party vendor specializing in Control Data compatible equipment. It is the offspring of International Time Sharing Services (ITSS), formed to provide engineering support of ITSS Control Data 3000 series equipment. KET states that its 5350 memory was designed to support the CDC 3500 and has been proven in applications supporting CDC 3300 equipment through minor changes to interface logic required to slow down the memory to meet the lower speed of the CDC 3300. Except for speed, KET explains, there is little difference between the CDC 3500 and 3300 equipment.

KET has at no point questioned the IRS's right to require that it be satisfied that proposed equipment will meet its needs, including benchmarking of equipment. However, the protester argues that its product has been fully proven through use of memory testing equipment which it has developed. This includes, we understand, substantial operating time supporting an in-house but smaller CPU configured to emulate performance characteristics of the CDC 3500. Central processing units are expensive. Simulation, KET argues, is an entirely appropriate and proper means of demonstrating equipment compatibility, at least in regard to normal applications.

Not only does KET contend that simulation should have been permitted, but it argues that the IRS could have taken advantage of the facilities and services provided by the Federal Computer Performance Evaluation and Simulation Center (FCPESC). At the very least, KET believes, the IRS could have attempted to obtain the use of these facilities or it could have recognized, as the Air Force has done, that circumstances may preclude economical duplication of testing facilities by other Governmental and private organizations. In this regard, the Department of the Air Force has stated that it will permit nongovernmental users to test equipment at Air Force facilities on a workload permitting basis, when: (1) required services are not reasonably available through private industry sources, (2) testing can be performed without additional manpower, (3) the Government is reimbursed for all direct and indirect costs, and (4)

the business requesting the test indemnify the Government against certain types of losses. See Notice, 43 Federal Register 22030, adding part 835 to 32 CFR, ch. 7C.

Prior to KET's filing of its complaint in the District Court, the contracting officer sought to argue that the Notice of Demonstration was "not a solicitation for goods or services [but] was only a request for demonstrations of memory units compatible with the CDC 3500 CPU's currently installed" at IRS. IRS's stated purpose in requiring the demonstration involved nothing more than a desire to simply test the market, i.e., "to [try] to discover if there is other compatible memory." In this connection IRS counsel acknowledged that:

> "* * * Should the results of this demonstration indicate that compatible memory is available, and should the [IRS] develop a requirement for such memory, present plans call for the [IRS] to conduct a competitive procurement* * *." "Supplemental Legal Memorandum" dated and submitted to GAO on August 11, 1978.

Throughout, KET has contended that the IRS was being less than candid because the current contract with CDC would expire on October 31, 1978, unless some action were taken. As documents received in our Office since the case was filed in the District Court indicate, IRS counsel knew or should have known that in fact no responses were received to the Notice of Demonstration from any potential offeror. Moreover, on August 15, 1978 the Contracting Officer executed Determination and Findings (D & F) to justify the exercise of options to purchase the existing CDC equipment in connection with a request for a Delegation of Procurement Authority from the General Services Administration (GSA).

As indicated, KET takes exception to the exercise of the options, asserting that it could compete were it only given a fair opportunity.

While we do not review contract administration matters pursuant to our bid protest procedures, we pointed out in H.G. Peters & Company, B-183115, September 27, 1976, 76-2 CPD 284, that we will consider protests

against the exercise of contract options when it is alleged that such action is or would be contrary to applicable regulatory provisions governing the exercise of options. Moreover, this Office considers protests which assert that a procuring activity's actions in modifying or extending a contract violate the statutory requirement for competitive procurements and deprive the protester of its right to compete for the Government's business. American Air Filter Co.--DLA Request for Reconsideration, B-188408, June 10, 1978, 57 Comp. Gen. ___, 78-1 CPD 443; Intermem Corporation, B-187607, April 15, 1977, 77-1 CPD 263.

As first revealed in Court, IRS intends to purchase the existing Control Data equipment by exercising purchase options under the existing contract, in lieu of competing its requirement. The reasonableness of option prices should be determined at the time the option is to be exercised, as a matter of sound procurement practice, just as any bid must be evaluated for price reasonableness before award. Admittedly, the Federal Procurement Regulations (FPR) contain no provision comparable to Defense Acquisition Regulation (DAR) § 1-1505, which directs steps to be taken by a contracting officer before an option is exercised. Specifically, DAR §§ 1-1505(d), (e) require that exercise of the option be justified on the basis of the results of a new solicitation, unless: (1) an informal market survey or examination of readily ascertainable established prices clearly indicates that better terms cannot be obtained, or (2) the time available is so short that option terms can be shown to be the best available, considering factors such as market stability and available time, and the usual duration of such contracts. In the absence of specific regulations relating to the exercise of options, the statutory and regulatory mandate that awards be made competitively imposes, we believe, several fundamental requirements which should have been applied in this instance.

In analogous circumstances we have recently stated, concerning the application of the competition statute to contract modifications, that:

> "The impact of any modification is in our view to be determined by examining whether

> the alteration is within the scope of the competition which was initially conducted. Ordinarily, a modification falls within the scope of the procurement provided that it is of a nature which potential offerors would have reasonably anticipated under the changes clause." American Air Filter Co.--DLA Request for Reconsideration, supra.

Whether sufficient concern for competition is shown in exercising an option depends in our view on the circumstances from which the option arose as well as upon the actions taken by the Government in determining that it should be exercised. In those instances where the option price was not evaluated in making the initial award but was only added by a subsequent modification to the contract, the procedures followed in exercising the option should comport, as much as possible, with the competitive norm of federal procurement. This requires that potentially interested suppliers be afforded adequate notice of and a fair opportunity to participate in the evaluation of their products and prices. See, e.g., General Electrodynamics Corporation,--Reconsideration, B-190020, August 16, 1978, 78-2 CPD 121.

Moreover, pricing normally can be adequately assessed only through competition. Olivetti Corporation, B-187369, February 28, 1977, 77-1 CPD 146. Regarding the use of prequalification techniques in connection with the exercise of an option, we have held that an agency is not required necessarily to solicit prices to ascertain whether to exercise an option provided it can fairly determine without doing so that no other firm could meet one or more of its essential requirements. Consolidated Airborne Systems, Incorporated, B-177758, July 10, 1974, 74-2 CPD 15.

We recognize that we have expressed doubt about, or have discouraged, the use of option testing procedures. See, for example, the concern we expressed as to whether it would be "sound procurement policy for the Government to put itself in a position where bids are requested solely for the purpose of determining whether an available option price can be bettered." 41 Comp. Gen. 682, 687 (1962). However, we believe that the better and

sometimes only effective method of determining whether the exercise of an option is appropriate is to submit the requirement to the test of competitive bidding. See, e.g., B-173141, October 14, 1971. Where competition is solicited for such purposes, of course, offerors should be advised of the purpose for which pricing is sought. B-173141, supra; B-173376, August 16, 1971.

Although as the IRS states, the CDC contract was initially awarded in 1970, the purchase option credits--and indeed, the installation of CDC 3500 equipment--resulted from Modification 42 issued in 1974. KET suggests that the modification was itself improper, citing our decisions in American Air Filter, supra. Regardless of the propriety of the action taken in 1974, it is clear that the purchase option pricing is not the result of or tested by a competitive procurement.

Even though in this case the D & F never quite says so, it is clear that IRS seeks to justify the exercise of the CDC option on the basis of the absence of competition because of KET's (or anyone else's) failure to respond to its request for a demonstration. If this is not what was meant, the D & F is deficient because no relative cost justification was included--only a finding by the contracting officer that to exercise the purchase option this year would save the Government $530,000 over what it would pay CDC if such action were taken next year. KET states that IRS would save substantially more than that by leasing KET equipment and that it would be less expensive for the Government to lease or buy KET equipment now than it would be to exercise the CDC options. The IRS evidently has not done a market (i.e., price) analysis, and in any event, does not contend otherwise.

Concerning the reasonableness of the demonstration requirement, the IRS denies any intent to unduly restrict competition. It asserts that because of prior unfortunate experiences with unproven peripheral equipment it believes it can consider only equipment which is in its opinion fully proven.

In KET's view, the IRS's actions are little more than a disguised attempt to eliminate it from consideration. On August 31, 1978, KET was awarded a contract by the Walter Reed Army Institute of Research (Walter

Reed) to install KET 5350 memory to support a CDC 3500 located at the Walter Reed Army Medical Center in Washington, D.C. The KET equipment has been installed. KET's counsel stated in the District Court that this equipment is now operating as intended. Had the IRS been interested only in surveying the market without immediate procurement ramifications, it could have agreed (as it has not) to extend the testing period so that KET could make use of the CDC 3500 located at Walter Reed. Moreover, KET complains, it made every reasonable effort to locate a CDC 3500 which it could use to perform the demonstration test. As stated before our Office, KET has always been willing to purchase CDC 3500 operating time as required to satisfy any doubt the IRS may have regarding its equipment.

We do not find it surprising that KET has not previously demonstrated or tested the KET 5350 on a CDC 3500, notwithstanding that the 5350 memory was designed for CDC 3500 applications. We hardly would expect manufacturers to purchase a mainframe to test every memory application they seek to develop. Not only are mainframes expensive, but the CDC 3500 apparently is not in current production. As KET states, approximately 50 units were manufactured by Control Data. Of the 40 units KET has been able to locate, 19 are controlled by the United States, eleven of which are operated by the IRS. Thirteen units not operated by the United States are located outside the United States. The remaining 8 are used by state governments, or by commercial and nonprofit organizations. By the extended IRS deadline of July 31, 1978, KET was unable to come to an agreement with any known CDC 3500 operator as to terms under which KET could have installed and demonstrated its 5350 memory.

The IRS dismisses KET's contentions that KET 5350 memory is compatible with CDC 3300 series equipment, and in any event believes that there is significant difference between CDC 3300 and CDC 3500 compatible memory. As far as the IRS is concerned, only actual operating experience on a CDC 3500 exactly like those used by the IRS will suffice and compatibility with the CDC 3500 cannot be established by simulation. In its opinion, demonstration of the memory on any other equipment or in any other testing environment could demonstrate at most that the equipment works only with that equipment or in that environment.

The IRS seems to believe that it is sufficient that it simply claim that it possesses a reasonable basis for requiring the demonstration test or in insisting that simulation not be permitted. In our view the IRS has not carried its evidentiary burden once KET established--as we believe it has--prima facie support for its contention, in effect, that the demonstration procedures followed were unduly restrictive of competition. As we noted in American Air Filter Co.--DLA Request for Reconsideration, supra:

> "While we believe that an agency's opinion regarding technical facts is entitled to consideration, a conclusion by technical personnel regarding the legal implications of their findings carries no more weight than any other conclusion of law."

Although we do not suggest that it is improper for the IRS to insist that KET, or others, demonstrate by benchmark testing during the course of procurement that products perform as claimed, it normally may be acceptable for a manufacturer in KET's position to "prove" its equipment through simulation testing techniques. Simulation and related disciplines, including scaling and modeling, are a part of the engineer's stock-in-trade. Cf., e.g., Applied Science & Technology Index, v. 66, No. 8, 79-80 (September 1976); id., 1331-1332 (1977); Bibliography of Selected Rand Publications, "Computer Simulation" (Rand, 1972). We cannot accept uncritically the IRS's contention that in no case is simulation acceptable regardless of how good it may have been, particularly where the actual equipment for determining the acceptability of competing products was either unavailable or the agency was unwilling to make it available.

In our opinion, an agency seeking in good faith to foster maximum competition at least would have: (1) explored the possibility of permitting simulation data in lieu of actual CDC 3500 experience or insist that firms demonstrate satisfactorily that simulation data could provide assurance of equipment acceptability; (2) supported its refusal to consider CDC 3300 operating data by identifying the specific differences in capability which would have to be shown to be met, and how those

differences could be shown to have been overcome satisfactorily; (3) provided a fuller explanation of its reasons for refusing to permit its own equipment to be used in conducting such a test, including scheduling information showing that possible use of the equipment was fairly considered but in fact was not possible. In the circumstances, IRS has given the appearance of creating unduly restrictive testing requirements designed to frustrate the statutory requirement that maximum competition be obtained in awarding Government contracts. In any event, we understand that at this time KET is able to demonstrate its equipment in operation at Walter Reed and we think it should be permitted to do so before IRS purchases the equipment from CDC.

Although the IRS must be held accountable for its failure to diligently pursue a competitive follow-on contract, or to properly evaluate the purchase options, IRS's actions have left it without a contract for necessary services and equipment. In our opinion, the IRS should negotiate with Control Data to extend the term of the existing contract, for such time as is reasonably required to permit a competitive procurement action to be conducted. In this connection, we note that by letter of October 20, 1978, GSA has granted a delegation of procurement authority to IRS to extend the existing lease on a month-to-month basis, but not for more than six months, in order to accomplish the competitive acquisition of the memory and disk subsystems. The authority granted by GSA requires, as a minimum, that KET plug compatible products be adequately considered. Moreover, inasmuch as GSA has refused to accede to IRS's request for authority to exercise the subject purchase option, IRS cannot properly do so. We believe our decision of today is consistent with this GSA action.

The protest is sustained.

Deputy Comptroller General
of the United States