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DECISION

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

[Validity of Method of Payment Provisions in AID Contracts]

FILE: B-196556 DATE: August 5, 1980

MATTER OF: Department of State--Method of Payment Provisions

DIGEST:

1. Characterizing management fees as "fixed fees based on different levels of effort" does not prevent contract from being contrary to statute when all elements of cost-plus-a-percentage-of-cost system of contracting are otherwise present.

2. In cost-plus-a-percentage-of-cost contracting, fact that payment in addition to actual costs is at predetermined dollar amount, rather than at predetermined percentage rate, is immaterial when contractor's fee increases in direct proportion to costs of performance.

3. Administrative safeguards are not sufficient to save contract from being construed as cost-plus-a-percentage-of-cost system of contracting. Such safeguards may be considered, however, in determining whether amounts paid equal reasonable value of goods or services provided.

4. When procurement is invalid due to failure to comply with Federal statute, Government has obligation to pay reasonable value of goods or services provided on quantum meruit or quantum valebat basis.

The Department of State has requested our opinion on whether the method of payment provisions in two Agency for International Development (AID) contracts violated the prohibition against the cost-plus-a-percentage-of-cost system of contracting of 41 U.S.C. § 254(b) (1976). For the reasons outlined below, we find that they did.

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The contracts, No. 492-1501 with E-Systems, Inc. (E-Systems) and No. 492-1504 with Heli Orient Ltd. (Heli Orient), were funded by the Bureau of International Narcotics Matters. They covered maintenance, supply, and related services necessary to operate aircraft provided to the Government of Burma for its Narcotics Control Program. AID negotiated the contracts sole-source at estimated costs of $1.5 million for E-Systems and $2 million for Heli Orient.

Both are labeled "fixed price technical service contracts." Certain costs, including items serviced at the contractors' facilities, were fixed, either according to the contractors' list prices or established wage rates. For other items, including materiel and equipment shipped to or from Burma and work performed by subcontractors, however, the contractors were to be paid actual costs and, in addition, a management fee on the following sliding scale:

Monthly Total	Management Fee
$ 0 - 5,000	$ 250
5,001 - 10,000	750
10,001 - 15,000	1,250
15,001 - 20,000	1,750
above 20,000	750 plus 500 for each additional $5,000 of invoiced costs

In addition, Heli Orient was to be paid $1,000 for each $50,000 of invoiced costs for maintenance of F-27 aircraft, excluding engines.

AID believes that the management fee provisions did not violate the statute because they are not a percentage of costs, but rather "several different fixed fees based on different levels of effort." In addition, AID states, the contractors have no substantial control over invoiced costs and normally have very limited choices in sources of supply. Finally, according to AID, work orders are controlled and progress is monitored by both the Burmese Government and by the contracting officer's technical representative. Consequently, AID concludes, the contractors have no real opportunity to increase their fees by choosing inefficient or costly suppliers or subcontractors.

The usual guidelines applied by our Office in determining whether a contractual arrangement violates the cost-plus-a-percentage-of-cost prohibition are (1) whether payment is at a predetermined percentage rate; (2) whether this rate is applied to actual performance costs; (3) whether the contractor's entitlement is uncertain at the time of contracting, and (4) whether it increases commensurately with increased performance costs. Federal Aviation Administration, 58 Comp. Gen. 654 (1979), 79-2 CPD 34; Marketing Consultants International Limited, 55 Comp. Gen. 554 at 562 (1975), 75-2 CPD 384.

In the latter case, we held that the cost-plus-a-percentage-of-cost prohibition was violated by the following fee arrangement:

Dollar value of invoice:	Contractor's reimbursement
$ 0 to 24,999.99	13.5 percent
25,000 to 49,999.99	11
50,000 to 74,999.99	8.5
75,000 and above	6

In the AID contracts, payment is at a predetermined dollar amount, rather than at a predetermined percentage rate. However, the rate is applied to the contractors' actual performance costs; the contractors' entitlement is uncertain at the time of contracting; and, most significantly, the contractors' profit increases with increased performance costs.

We do not believe that characterizing these as fixed fee contracts, merely because some of the items to be delivered or services to be performed will be at a set price, or characterizing the management fee as a fixed fee which varies with level of effort, prevents these contracts as a whole from being contrary to statute. As we have pointed out, what Congress provided against was not a cost-plus-a-percentage-of-cost contract, but such a "system of contracting." 22 Comp. Gen. 784 (1943). The "evil" of this system is that contractors have an incentive to pay liberally for reimbursable items, because higher costs mean higher profits. See 55 Comp. Gen. supra at 562, quoting Muschany v. United States, 324 U.S. 49 (1945). We do not believe there is a meaningful distinction

here merely because in the AID contracts fees are expressed in dollars rather than percentages, for the fact remains that the contractors' fees still increase in direct proportion to actual costs incurred.

We do not doubt that the contractors in this case may have little choice among suppliers or that monitoring and reporting will be required. We have long held, however, that administrative safeguards are not in themselves sufficient to save a contract from being construed as a cost-plus-a-percentage-of-cost system of contracting. Such safeguards may be considered, however, in determining whether amounts paid approximate the reasonable value of the goods or services provided. See 38 Comp. Gen. 38, 40 (1958), and cases cited therein.

We therefore find that the contracts with E-Systems, and Heli Orient violated 41 U.S.C. § 254(b), supra.

The two contracts expired March 1, 1980, and the contracting officer states that the management fee provisions will not be included in competitively-negotiated, follow-on contracts. The only remaining question for our Office is the propriety of payment of the contractors, who under terms of their contracts have been reimbursed in part following submission of monthly invoices.

When a procurement is invalid due to failure to comply with a Federal statute, our Office and the courts have recognized that the Government has an obligation to pay the reasonable value of the goods or services provided on a quantum meruit or quantum valebat basis. See 58 Comp. Gen. supra; B-166790, April 12, 1973. In this regard the contracting officer expresses an opinion that the payments made to the contractors reflect the reasonable value of the services rendered. We would not object to the payments made to these contractors if the contracting officer's opinion is verified to be correct.

Milton J. Socolar

For the Comptroller General
of the United States