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DECISION

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

FILE: B-212191 **DATE:** November 17, 1983

MATTER OF: Holmes & Narver Services, Inc., and Morrison-Knudsen Company, Inc.

DIGEST:

GAO sustains protest challenging agency decision to perform services in-house based on comparison of government estimate with protester's offer, since agency failed to comply with procedures for conducting the cost comparison identified in the request for proposals, and that failure casts doubt on the validity of the outcome of the comparison.

Holmes & Narver Services, Inc., and Morrison-Knudsen Company, Inc., a joint venture (HN/MK), protest a decision by the Redstone Arsenal, United States Missile Command, Procurement and Production Directorate, Huntsville, Alabama (Redstone), pursuant to an Office of Management and Budget (OMB) Circular A-76 cost comparison, to continue furnishing base operations and maintenance services through federal employees (in-house) rather than HN/MK, the low offeror under requests for proposals (RFP's) Nos. DAAH03-82-R-0002 and DAAH03-82-R-0033.

The protest is sustained.

The solicitations were issued on February 23, 1982. Initial proposals were submitted on August 2, 1982, and best and final offers were submitted on February 24, 1983. A conditional award was made to HN/MK on the basis of a comparison of HN/MK's low offer with the government's in-house estimate, which indicated that the protester's price of $346,696,994 (4 years and 10 months) was $986,867 lower than the government's in-house estimate of $349,917,068. The award was conditioned on the results of the appeal period and final clearance from higher headquarters to proceed with contract commencement.

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A federal employee union appealed the cost comparison to the Administrative Appeals Board for Commercial/ Industrial Activities (Board). The Board's April 25, 1983, decision sustained two of the union's four grounds of protest. The Board determined that the government's estimate improperly inflated Davis-Bacon type construction costs ($824,818) and supervisory/foreman labor wages ($268,632) for option years. The Board reduced the government's estimate by $1,093,450. This made the government estimate low by $106,583.

HN/MK, which had not been permitted to participate in the union's appeal, appealed the Board's April 25 decision. HN/MK challenged the two April 25 adjustments and raised 10 other points of error. Unknown to HN/MK, the Board also considered an appeal by an individual federal employee regarding an alleged discrepancy between the RFPs' and the in-house estimate's statement of work. On June 10, 1983, the Board determined that its April 25 reductions were correct, yet agreed with HN/MK on four other issues. Two of HN/MK's issues (Wage Board (WB) rates and underutilized capacity) denied by the Board are discussed below. The Board's June 10 decision also sustained the individual employee's protest as to the alleged discrepancy in the statements of work. This latter issue reduced the government's estimate by the amount of $1,994,462. The net result of the June 10 adjustments was that the government's estimate was low by $1,972,874.

The RFP contained a Notice of Cost Comparison (Negotiated) pursuant to Defense Acquisition Regulation (DAR) § 7-2003.89 (Defense Acquisition Circular (DAC) No. 76-28, July 15, 1981), which advised offerors that the solicitation is a part of a cost comparison to determine whether accomplishing the specific work in-house or by contract is more economical.

We generally do not review an agency decision to perform work in-house rather than to contract out for the services because we regard the decision as a matter of policy within the province of the executive branch. Crown Laundry and Dry Cleaners, Inc., B-194505, July 18, 1979, 79-2 CPD 38. Where an agency, however, utilizes the procurement system to aid its decision, specifying the circumstances under which a contract will or will not be awarded, we will review an allegation that the agency did not follow established cost comparison procedures, since a faulty or misleading cost comparison which would materially affect the decision whether or not to contract out would be abusive of the procurement system. MAR, Incorporated, B-205635, September 27, 1982, 82-2 CPD 278.

June 83 Wage Board Increase

WB rates for prevailing rate employees are locally determined on the basis of wage surveys of public and private sector workers in the local geographic area. See 5 U.S.C. §§ 5341-49 (1982). Each wage area schedules different times for its annual survey. See Appendix "C" of Federal Personnel Manual Supplement § 532-1. The Huntsville, Alabama, area is reviewed in April and new rates are announced on approximately June 1 of each year. HN/MK protests that the June 1983 increase should have been included in the in-house estimates of direct labor costs because it went into effect before October 1, 1983. (The first year of performance was to be from October 1, 1983, to September 30, 1984.)

Development and Readiness Command (DARCOM) advised the in-house estimate preparation group on February 3, 1983, to not consider WB employee increases for June 1, 1983, and beyond in computing the first year of performance because the inflation indices to be used to inflate civilian labor costs through the first year of contract performance should be based on the fiscal year which spans the greatest period. The Army argues that, insofar as WB rates at Redstone Arsenal are renewed each June, the proper inflation assumption would be to use the fiscal year '84 inflation index of 0 percent because June 1983 is closer to October 1, 1983, than October 1, 1982, and the salaries for WB employees would span a greater portion of fiscal year '84 (8 months) than fiscal year '83 (4 months). The Army ignored, therefore, the June 1983 increase and the pre-June wages were treated as fiscal year '84 wages.

HN/MK contends that this approach is improper because it fails to fully cost direct labor for the entire first year of performance and is contrary to specific provisions of the OMB Circular A-76 Cost Comparison Handbook (Handbook). Page 21 of the Handbook, under the section entitled "Direct Labor--Line 2," states:

> ". . . When a salary increase for Government employees is expected during the first year of performance, the amount of the increase should be included in the direct labor estimate."

Similarly, pages 49-50, under the heading "Inflation Of Out-Year Costs--Line 8," states:

> "In preparing the Government's estimate, all known or anticipated increases in costs to be incurred in the first year of operation should be provided for in each element of cost, as stipulated by the instructions contained in this Handbook, including any expected salary increases for government employees. . . ."

These requirements of the Handbook are to insure that the government's direct labor costs are accurately reflected. Although it appears that the Army intended that the approach used would here provide a more equitable cost comparison of in-house versus contract performance, see Joule Maintenance Corporation, B-208684, September 16, 1983, 83-2 CPD 333, the application of the approach under the circumstances of this case distorts the in-house estimate because the direct labor estimate is based on pre-June 1983 wages rather than October 1, 1983, wages. If, for example, a Redstone WB employee was paid at a rate of $9 per hour in May 1983 and received a dollar per hour increase on June 1, 1983, his October 1, 1983, wage rate would be $10 per hour. Although he will not receive a wage increase in fiscal year '84, he will retain his June 1, 1983, $1 per hour increase. His fiscal year '84 wage rate will be $10 rather than $9 per hour. The government's cost of paying the dollar increase during the contract must be reflected in the in-house estimate's direct labor costs. The Army has ignored the cost by simulating an in-house estimate in which the Redstone WB employees will still be paid at their May 1983 wages.

The Army contends that it could not consider the June 1983 increase since the results of the wage survey were not announced until May 1983 and, therefore, could not be anticipated at the time of the February 23, 1983, best and final offers. As noted above, the Huntsville, Alabama, area is reviewed each April and an announcement is made each June. However, it is clear that the in-house estimate preparation group anticipated the June increase because they specifically requested DARCOM's advice on February 3, 1983, regarding whether the raises scheduled for June should be considered. Although the precise amount of the June increase was not known at the time, the Army's August 1982 and February 1983 inflation guidance advised that a 4-percent increase was to be anticipated for fiscal year '83 and no increase was anticipated for fiscal year '84. Since the June '83 increase was to occur during fiscal year '83, the Army should have anticipated that the June '83 increase would be 4 percent. The Handbook requires that all known or

anticipated increases be included in each element of cost. The Army's inflation guidance provided the mechanism through which Redstone could have complied with this requirement.

The Army also argues that its action was consistent with the January 21, 1982, DARCOM guidance, which indicates that in-house costs for occupations subject to the Service Contract Act (SCA), 41 U.S.C. § 351, et seq. (1976), should only be escalated up to the end of the period for which the latest Department of Labor (DOL) rates are applicable. The period for which the DOL wage determination in this case is applicable is October 29, 1982, to October 30, 1983.

Although the Army never states so explicitly, it appears that the Army is advancing the same argument that we rejected in Joule Maintenance Corporation, supra (which also involved DARCOM's guidance), namely, that the use of lower wages on the government side was to compensate for the fact that higher wages would be payable at the end of the applicable wage determination period because higher wages would be taken care of through an SCA price adjustment pursuant to DAR § 7-1905(b) (DAC No. 76-20, September 17, 1979). (Joule Maintenance Corporation involved a fiscal year '83 contract with a DOL determination applicable until December 31, 1982.) In Joule Maintenance Corporation, we stated:

> "The Army . . . misconstrues the application of the SCA. The contractor would get an economic price adjustment only if higher wages had to be paid. We are not aware of any reason why higher wages would have to be paid during the first year of the contract. DOL regulations clearly provide that wage determinations issued or revised after contract award do not apply to the initial performance period of the contract. See 29 C.F.R. §§ 4.5(a), 4.164(c) (1982). [See also Suburban Industrial Maintenance Co., B-190588, March 6, 1978, 78-1 CPD 173.] Therefore, even though a new wage determination was anticipated for calendar year 1983, the new rates would not automatically be applicable to the contract during the first year (through September 1983) and the Government would not have to absorb any additional costs under the price adjustment clause. Therefore, there appears to be no basis for the offsetting reduction in the Government's estimated labor costs. Thus, we agree with Joule that the Army improperly failed to

> fully cost its direct labor for the first contract year as required by the Handbook."

The Army has not attempted to distinguish or question Joule Maintenance Corporation. Our reasoning in that case is equally applicable here and is dispositive of the issue.

We conclude that the Army improperly failed to fully cost its direct labor as required by the Handbook.

Underutilized Capacity

Line 24 of the cost comparison worksheet is entitled "Utilization of Government Capacity." The Handbook, pages 69-70, explains that this factor is intended to measure the impact on the work center of contracting for a service that the work center currently provides. The decision to contract can result in the work center becoming completely idle, operating at a reduced capacity, or operating at the same or increased capacity. If contracting would cause the work center to operate at less than its current level of utilization of capacity, the cost, if any, of this underutilization of capacity must be considered. In that case, any overhead/general and administrative costs currently allocable to the service being considered which will continue to be incurred if the service is contracted must be absorbed by the remaining in-house activities. These continuing costs are a cost of contracting, and they must be charged, in the course of comparing costs, to the bidder. This is accomplished by adding line 24 to the total cost of contracting.

The Handbook, page 73, provides that the increased cost attributable to underutilized capacity due to contracting should be added to the cost of contracting for the first year and for each subsequent year "unless it is likely that the agency will dispose of or be able to more fully utilize the excess capacity through reorganization or relocation of work." See Technicolor Government Services, Inc., B-209577.2, September 21, 1983, 83-2 CPD 353.

However, this provision has been modified by OMB Transmittal No. 6 (TM-6), 47 Fed. Reg. 4629, February 1, 1982, which provides:

> "In charging underutilized capacity do not include any underutilized personnel-related cost on line 24. Prudent management will ensure that personnel are assigned to other tasks or reductions made in the size of the

> overhead organization. Therefore, these costs are not properly chargeable to the cost of contracting out."

HN/MK protests that the Army erroneously determined that TM-6 was inapplicable and, therefore, added underutilized personnel-rated costs to HN/MK's offer, which caused it to be overstated by $15.9 million.

The Army contends that there was insufficient time before the receipt of initial offers on August 2, 1982, to apply TM-6. With regard to its applicability, TM-6 provides:

> "This revision is effective immediately and shall apply to all studies in process where no cost comparison has been made, provided there is sufficient time to make changes prior to submission of the Cost Comparison Form to the contracting officer by the date specified for contractor proposals or bids."

Nevertheless, Redstone was advised by Message 252015Z Feb. 82:

> "To date OSD has not repeat not approved OMB Transmittal Memo No. 6 for implementation within the Defense Department. Therefore, addressees are advised not to use any of the policies contained in the Memo until approval is granted."

TM-6 was officially implemented by the Army on July 27, 1982, 3 working days before the receipt of initial offers.

Subsequent to the receipt of initial offers, the solicitation was amended three times. The third amendment was to comply with section 1111 of the 1983 Department of Defense Authorization Act, Pub. L. 97-252, 96 Stat. 718, 852 (1982), which prohibits the use of appropriated funds to enter into contracts for the performance of firefighting functions at military installations. See, generally, InterCon Security Systems, Inc., B-208551, January 26, 1983, 83-1 CPD 93. This procurement for operation and maintenance services included firefighting functions. It therefore was necessary to revise the in-house estimate and all offers. Revised offers were due December 2, 1982.

Although the Army revised the cost study to comply with the Authorization Act, it was not revised to comply with TM-6. We consider this to have been improper. At the time the Authorization Act was enacted, TM-6 had been approved for Department of Defense (DOD) use and was applicable to all cost comparison studies in process, provided there was sufficient time to make changes prior to the date specified for the receipt of proposals. Redstone had sufficient time before revised offers were due on December 2, 1982, to include TM-6 revisions into the cost study which was once again in process.

The Army contends that OMB excused it from implementing TM-6. A November 16, 1982, record of a telephone conversation with an OMB official indicates he stated that the in-house estimate did not have to be revised to comply with TM-6 because the cost study was basically completed on February 8, 1982, prior to DOD acceptance. However, the telephone record does not indicate that the OMB official was informed that the cost study was in process of being revised. His advice regarding the implementation might have been different if he had been so informed.

Davis-Bacon Act

The Board's April 25 decision sustained a federal union's appeal that in-house construction labor was improperly inflated. The Board reduced the in-house estimate by $824,818. The Board noted that the protester was required to comply with Davis-Bacon Act wage rates and reasoned as follows:

> "The wage rates set forth in the above identified determinations are static and are not subject to either economic adjustments due to inflation or replacement by later determinations; thus, the contractor need not apply economic adjustment factors to its bid or proposal. Since the contractor is not obligated to apply economic adjustment factors to its bid proposal, the in-house bid, to be fully comparable to the contractor's bid, should not have inflation applied to wage rates for labor associated with construction."

This solicitation is for a base year, 3 full option years, and a fourth option year of 10 months. Army concedes in its report to our Office that new wage rates would become applicable upon the exercise of the options. The Army,

nevertheless, contends that the Board's decision was correct:

> "Any contract resulting from solicitation DAAH03-82-R-0002 would be for a year with annual options for a total of four (4) years and ten (10) months. Each new contract (option exercise) would require a new Davis-Bacon wage rate and require the employer to pay any increase in wages to the employee. Neither the Davis-Bacon Act nor the Defense Acquisition Regulation (DAR) contemplated a contract with options for construction type work; therefore, there is no adjustment clause in the Act or the DAR. The solicitation further did not contain a special provision to handle the situation.
> . . .
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> ". . . A review of H&N/M-K's cost proposal by the procurement office reveals that H&N/M-K, in their proposal for the 90,000 hours from which construction type work was to be ordered, inflated costs in the outyears for supervisors only and that the wage labor categories within the wage determination for Davis-Bacon Act were comparable to the DOL rates.
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> ". . . Recognizing that the Army would have to mandate the use of a new wage rate, but also recognizing that it would be unjust to require the contractor to incorporate a new wage rate that was not available for review prior to the offer, the Army would have to allow an equitable adjustment in the contract to cover any increased rate. Therefore, since the contractor would be entitled to an equitable adjustment, equivalent to the economic adjustment contemplated by OMB Circular A-76, for the Davis-Bacon type work, the Government should be allowed to treat the Davis-Bacon effort similar to the Service Contract Act work for the purpose of not inflating the outyears to insure comparability between the contractor and the Government."

TM-6, attachment "A," states:

> "4. In cases where a contract for the needed product or services would include some form of economic adjustment clause for subsequent years, no allowance for inflation of those costs protected by the adjustment clause is included in out-year contract pricing, and corresponding costs of Government performance should not be inflated. For example, contracts subject to the Service Contract Act include a clause that provides for adjustments to accommodate labor-cost increases necessitated by future minimum wage determinations. Accordingly, when contract performance would be under a contract subject to the Service Contract Act, labor costs for Government employees in occupations that would be included in the Act should be deducted from the base for inflation calculations."

See also Contract Services Company, Inc., B-210796, August 29, 1983, 83-2 CPD 268.

HN/MK contends that it assumed the risk of any future wage determinations with which it would have to comply. However, the Davis-Bacon clause incorporated into the solicitations, DAR § 7-602.23(a), only requires that payments be made in accordance with the "wage determination decision of the Secretary of Labor which is attached hereto and made a part hereof." HN/MK therefore assumed no risk because the solicitation does not require that it pay future wage determination increases.

Although the solicitations do not contain an equitable adjustment clause for Davis-Bacon wage increases, the Army indicates that the option year contracts will be modified (apparently under the changes clause) to incorporate any new Davis-Bacon rates. This revision will entitle HN/MK to an equitable adjustment to the extent that it can show that the revision has made performance more expensive. Space Age Engineering, Inc., ASBCA 16588, 72-2 BCA 9636; Philco-Ford Corp., ASBCA 14623, 72-1 BCA 9390; Geronimo Service Company, ASBCA 14686, 14687, 70-2 BCA 8540. Although the equitable adjustment would be pursuant to the changes clause rather than a Davis-Bacon equitable adjustment clause, the cost that the government will incur upon amending the contract is relevant to determining the government's true cost in contracting out. We conclude that the Board properly determined that the in-house cost of construction labor should not be inflated because the government would pay an equitable adjustment if the procurement is contracted out.

Service Contract Act

The Handbook requires that a prescribed inflation factor be applied to the salary of Government employees to account for salary increases after the first year of operation. Handbook, Ch. III, Para. H. The DOD's Appendix "D" of the Handbook and TM-6, attachment "A," quoted supra, state that the inflation factor is not to be applied to positions that would be subject to the SCA, supra, if the services were provided by contract.

In its April 25 decision, the Board determined that the government had improperly applied the inflation factor to 22 wage supervisor positions that would be subject to the SCA if the services were provided by contract. The Board accordingly reduced the in-house estimate by $268,632.

HN/MK protests that the wage supervisors are bona fide executives as defined by 29 C.F.R. § 541.1 (1982) and are, therefore, exempt from the SCA. See 41 U.S.C. § 357(b); 29 C.F.R. § 4.156 (1982). HN/MK argues that all wage supervisors are bona fide executives. However, the provisions of 29 C.F.R. part 541 are not so simple. For example, a supervisor who performs an excess amount of "nonexempt work" may be a working foreman subject to the SCA rather than an exempt bona fide executive. See 29 C.F.R. §§ 541.115(a), 541.1(e), 541.101. See generally Joule Technical Corporation, 58 Comp. Gen. 550, 555 (1979), 79-1 CPD 364; 53 Comp. Gen. 370 (1973). In this case, we have no more than conflicting assertions regarding the applicability of the SCA. The enforcement of the SCA is primarily the responsibility of the contracting agency and the DOL. 41 U.S.C. § 352(b). We recently held in Facilities Engineering & Maintenance Corporation, B-210376, September 27, 1983, 83-2 CPD 381, that an agency's determination (in conjunction with an A-76 cost comparison) that positions are subject to the SCA will not be questioned by our Office unless shown to be unreasonable. The protester has asserted nothing more than its disagreement with the Board. This does not meet the protester's burden of proof. Id. Thus, we have no basis to object to the Board's decision that the positions are not subject to the inflation factor.

Adjustment of In-house Estimate

HN/MK protests the Board's June 10 determination to sustain an individual employee's protest that the food service portion of the in-house estimate be recalculated because it was based on a different scope of work than was

contained in the RFP's. As a result of the employee's protest, the Board recalculated (reduced by $1,994,462) the in-house estimate on the basis of a scope of work that, with the exception of the historical data of meals served, was identical to the solicitations'. The historical data in the solicitations (1980 data) reflected 4 percent more meals than the current (August 1982) data that the government utilized in revising its estimate.

We have held that contractors and the government should compete on the basis of the same scope of work. In Joule Maintenance Corporation, B-208685, supra, we sustained a protest that a solicitation's statement of work was improper because it encompassed certain work that the in-house employees were not performing. This gave the Army an unfair advantage. We rejected the Army's argument that offerors should have been able to determine the actual scope of work from the historical labor hours included in the solicitation. We indicated that this data was an inadequate substitute for a precise, unambiguous description of work, stating:

> "Certainly it was not equitable to require Joule and other offerors to divine the extent of the work to be performed from historical hours while the Army knew precisely what work to include in its in-house estimate."

The same principle is applicable here. Although it was proper for the Board to adjust the in-house estimate so that it would be based on an identical scope of work, RCA Service Company, B-208204.2, April 22, 1983, 83-1 CPD 435, the historical data should also have been the same. The Army emphasizes that the historical data contained a statement that it was provided "for informational purposes only." However, this information is useful in estimating labor requirements. While it is unclear what impact the 4 percent difference in the historical data may have had, it was certainly not equitable to require HN/MK and other offerors to estimate the amount of work to be based on 1980 data that reflects 4 percent more meals than the 1982 data on which the government based its estimate.

Effect of Errors

The protester has demonstrated that the Army failed to follow established procedures. However, it must also demonstrate that this failure materially affected the outcome of the cost comparison. The protester may meet this burden where it presents sufficient evidence to raise a reasonable

doubt whether the results of the cost comparison would be different if the correct procedures were followed and the agency does not dispel that doubt. Serv-Air, Inc.; AVCO, 60 Comp. Gen. 44 (1980), 80-2 CPD 317. In this regard, we have held that it is essential to the integrity of the cost comparison process that the agency identify and document all elements of the comparison. MAR, Incorporated, supra.

The Army contends that the 4-percent difference in the historical data of meals served would have had little, if any, effect on cost. While the impact of this discrepancy alone may not exceed the $1,972,874 difference that the Board found between HN/MK's offer and the in-house estimate, it could become significant when considered in conjunction with the impact of other improprieties.

HN/MK contends that the Army's failure to apply TM-6 caused line 24 to be overstated by $15.9 million. (This figure does not take into account other possible impacts of TM-6.) The Army has not provided its own figure, yet contends that HN/MK's computations demonstrate that it is apparently confused as to the methodology for computing line 24. However, the Army's explanation is based on the inapplicability of TM-6. We are unable to determine the precise impact the application of TM-6 would have had. Conceivably, the application would more than offset the $1,972,874 difference between the HN/MK bid and the in-house estimate.

HN/MK has submitted detailed calculations to support its contention that the omission of the wage increase caused the in-house estimate to be understated by $2,031,693. (This alone would exceed the $1,972,874 difference between HN/MK's offer and the in-house estimate.) The Army estimated $51,756,170 direct labor costs for the 4 years and 10 months of the contract ($10,708,247 per year). This is based on pre-June 1983 wage rates. HN/MK contends that the addition of the 4-percent June 1983 increase for WB employees would raise the total direct labor cost by $1,449,362 ($299,211 per year). Direct labor cost (line 3) affects fringe benefits (line 4), operations overhead (line 5), general and administrative expenses (line 7), inflation (line 8), and the conversion cost differential (line 32). HN/MK calculates a $582,531 net increase in government in-house costs attributable to the effect of the $1,449,362 increase in direct labor costs on lines 4, 5, 7, 8 and 32.

The Army does not directly challenge the accuracy of these calculations. Instead, the Army states that "[c]omputations of the wage grade payraise of 4 percent for the

remainder of the DOL period (1 June through 30 Oct. 83) would result in an increase to the government's bid of approximately $750,000 for the entire period of the contract." This figure may be based on DARCOM's January 21, 1983, guidance, discussed supra, that wages need only be inflated through the end of the current DOL wage determination. The Army provides no indication as to how it arrived at this figure. It is unclear whether it includes the option years and the effect of the wage increase on costs such as fringe benefits, etc. In contrast, HN/MK has provided detailed calculations, the accuracy of which are not directly challenged, which demonstrate that the omission of the wage increase caused the in-house estimate to be understated by more than $2 million.

The foregoing casts doubt on the validity of the cost comparison made by the Army. Therefore, we recommend that a detailed cost comparison comporting with our decision be made. If, after appropriate adjustments, HN/MK remains lowest as to cost and is still willing to accept the award, the contract should be awarded to HN/MK.

HN/MK also protests the Board's appeal procedures and contends that its price may have been prematurely disclosed. In view of our recommendation, these alleged irregularities need not be addressed.

Since this decision contains a recommendation for corrective action, we are furnishing a copy to the congressional committees referenced in section 236 of the Legislative Reorganization Act of 1970, 31 U.S.C. § 720, formerly section 1176 (1976), which requires the submission of written statements by the agency to the House Committee on Government Operations, Senate Committee on Governmental Affairs, and the House and Senate Committees on Appropriations concerning the action taken with respect to our recommendation.

By separate letter of today, we are also notifying the Secretary of the Army of our recommendation and his obligations under section 236.

for Harry R. Van Cleve
Comptroller General
of the United States