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DECISION

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

FILE: B-215124 **DATE:** March 18, 1985

MATTER OF: Advanced Technology Systems, Inc.

DIGEST:

Protest contending that agency failed to conduct proper cost realism analysis resulting in defective evaluation and improper award to technically inferior, but 23-percent lower cost, proposal, is sustained where: (1) agency was concerned about the realism of the awardee's costs; (2) agency's cost realism analysis fails to assure that the awardee's proposed costs are realistic; and (3) agency's attempt to resolve question of cost realism by capping awardee's direct and indirect costs is of questionable efficacy in view of RFP provision which gives the awardee the right to reject, negotiate and dispute specific task orders leaving open the possibility that a contractor unable to perform within the confines of the cap will use its rights under the provision to excuse nonperformance.

Advanced Technology Systems, Inc. (ATS), protests the Department of Housing and Urban Development (HUD) award of a cost reimbursement, requirements-type contract under request for proposals (RFP) No. HC-12450 to Group Operations, Inc. (GOI). ATS, relying on an RFP clause which states, in part, "an offeror's proposal will not be considered when costs are determined to be unrealistically low," contends that HUD should have rejected the GOI proposal as unrealistically low. ATS argues that GOI's offer was a "buy-in" and "nonresponsive" to the RFP's realistic cost requirement quoted above.

We sustain the protest.

The solicitation is for automated data processing (ADP) development support services. The bulk of the work consists of furnishing technical personnel, although the successful offeror is required to also provide all necessary materials,

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services, equipment and facilities. Part of the work is to be performed onsite at HUD and part offsite at the contractor's facility. The RFP provided a fixed, lump-sum number of technical staff hours for each category of required personnel. Offerors submitted both technical and cost proposals describing their proposed approach to the work and the costs associated with that approach.

The RFP indicates that technical and cost factors will be evaluated for award. It is clear that the technical portion of the proposal will be point-scored and the cost portion examined for realism; however, there is no indication of the relative weight of the two factors. It appears that HUD intended to accord both factors substantially equal weight, which is consistent with our decision in University Research Corporation, B-196246, Jan. 28, 1981, 81-1 C.P.D. ¶ 50.

The source evaluation board (SEB) eliminated five of the eight proposals received from the competitive range after an initial evaluation. Oral discussions were held with the three remaining offerors, resulting in the following evaluation of best and final offers:

	Technical Score	Cost
GOI	57.5	$3,722,664
ATS	70.5	4,595,735
Third Offeror	59.3	4,824,059

ATS's technical score was 13 points, or 23 percent, better than GOI's; however, GOI's estimate of its cost was $873,071, or 23 percent lower, than ATS's costs. The SEB recommended (by a three to one margin) that the source selection official (SSO) award the contract to ATS. However, the SEB's contract advisor objected on the ground that both ATS and GOI were technically capable of performing the work and that ATS's 13-point technical edge over GOI was not worth the $873,071 difference. The SSO requested additional information on: (1) the nature of ATS's technical superiority; and (2) the reason for the $873,071 difference in proposed costs. The Defense Contract Audit Agency (DCAA) furnished information on GOI's current cost rate experience on other similar government contracts. After reviewing the DCAA information and acknowledging the concern of one SEB number that GOI was "low balling" its proposed personnel costs (direct labor rates), the dissenting contract advisor prepared a cost realism analysis for the SSO, which concluded:

> "It is apparent after reviewing the DCAA information that GOI is willing to perform at a lower cost than what they are experiencing currently. This same situation occurred when ATS won their first contract with HUD. If a contract is negotiated with GOI, ceilings will have to be established on the cost items to prevent the Contractor from buying in and making up the difference after contract award."

HUD reports that:

> "After reviewing the cost realism analysis, the SSO overruled the SEB and recommended that a contract be worked out with GOI which would ensure that reimbursement costs would not exceed the costs proposed by GOI for each component cost category comprising the total contract cost. This was to include the option period of the contract as well as the 18-month base period."

On April 26, 1984, HUD awarded GOI the 18-month (with one 18-month option), cost-plus-fixed-fee contract in the amount of $3,722,644 ($1,822,673 for the base period and $1,899,991 for the option period). HUD justifies the award on the basis that:

> ". . . GOI's technical score was within the competitive range, and GOI's proposal was determined to be most advantageous to the Government, price and other factors considered; e.g., the cost proposal offered a large saving to the Government."

When the government contemplates the award of a cost-reimbursement contract, the issues of buy-in and cost realism become proper issues for our review, because, as a rule, buying in on a fixed-price contract (the submission of a below-cost proposal) provides no basis for protest as long as the offeror buying in is responsible since it is the offeror's loss and not the government's if the cost of providing the required service or item exceeds the contract price. Fresh Flavor Meals, Inc., B-208965, Oct. 4, 1982, 82-2 C.P.D. ¶ 310.

However, when the contract to be awarded is a cost-reimbursement contract, the risk of loss as a result of a cost overrun shifts to the government. It is therefore necessary in cost-reimbursement contracting to be aware of the possibility of a buy-in and guard against its occurrence by analyzing proposed costs in terms of their realism since, regardless of the costs proposed by the offeror, the government is bound to pay the contractor actual and allowable costs. Bell Aerospace Company; Computer Sciences Corp., 54 Comp. Gen. 352 (1974), 74-2 C.P.D. ¶ 248. In this regard, Federal Acquisition Regulation, § 15.605(d), 48 Fed. Reg. 42,102 (1983) (to be codified at 48 C.F.R. § 15.605(d)), provides:

> "(d) In awarding a cost-reimbursement contract, the cost proposal should not be controlling, since advance estimates of cost may not be valid indicators of final actual costs. There is no requirement that cost-reimbursement contracts be awarded on the basis of lowest proposed cost, lowest proposed fee, or the lowest total proposed cost plus fee. The award of cost-reimbursement contracts primarily on the basis of estimated costs may encourage the submission of unrealistically low estimates and increase the likelihood of cost overruns. The primary consideration should be which offeror can perform the contract in a manner most advantageous to the Government, as determined by evaluation of proposals according to the established evaluation criteria."

In this vein, we have held it improper to award a cost-reimbursement contract on the basis that the costs proposed are reasonable, *per se*, merely because they are low when compared to other offers, without an appropriate analysis adequately measuring the realism of such low costs. Moreover, where the award of the contract is based ultimately on the estimated cost for performance of the contract, a determination of cost realism requires more than the acceptance of proposed costs as submitted. Joule Technical Corporation, B-192125, May 21, 1979, 79-1 C.P.D. ¶ 364. For these reasons, the evaluation of competing cost proposals requires the exercise of informed judgment which we believe must be left to the administrative discretion of the contracting agencies involved, since they are in the best position to assess "realism" of cost and technical approaches and must bear the major criticism for any difficulty or expenses resulting from a defective cost analysis. 50 Comp. Gen. 390 (1970). Since the cost analysis is a function of the contracting agency, we will not disturb an agency's determination unless it clearly lacks a reasonable basis. Moshman Associates, Inc., B-192008, Jan. 16, 1979, 79-1 C.P.D. ¶ 23.

Notwithstanding the general rule that the government bears the risk of cost overruns in the administration of a cost-reimbursement contract, there is an exception where the contractor has agreed to a cap or ceiling on its reimbursement for a particular category or type of work. In such a case, any loss occasioned by a cost overrun will be borne by the contractor and not the government. 51 Comp. Gen. 72 (1971), at 77. For this reason there are many cases where imposition of a cap or ceiling on direct and indirect costs can substitute for the performance of a cost realism analysis.

It is well established that selection officials (SSO) are not bound by the recommendations and conclusions of evaluators, like the SEB, and GAO will defer to an SSO's judgment, even when he disagrees with an SEB composed of technical experts. Moreover, the SSO's selection decision, reliance upon the results of technical/cost evaluations, and tradeoff decisions, if any, between technical superiority and cost are limited only by the tests of rationality and consistency with established evaluation factors. Grey Advertising, Inc., 55 Comp. Gen. 1111 (1976), 76-1 C.P.D. ¶ 325.

We agree with the protester that the award to GOI was inconsistent with the RFP's cost realism evaluation factor and that HUD's imposition of a cap on direct and indirect costs is of questionable efficacy, as a substitute for the performance of a cost realism analysis, under the particular circumstances of this case.

The record shows that HUD was concerned about the realism of GOI's proposed costs. HUD performed an inadequate cost realism analysis of GOI's proposed costs. The analysis consists of the following: (1) a statement that

GOI understands that HUD intends to impose ceilings; (2) a calculation of GOI's base period (based on the rates which DCAA reports GOI is currently experiencing) showing an increase of $460,627 over GOI's proposed costs; (3) a calculation of ATS's costs based on ATS's ceiling rates; and (4) two comparisons--GOI's proposed cost versus ATS's proposed cost (showing GOI lower by $873,071 over 36 months) and GOI's current costs versus ATS's proposed ceiling costs (showing GOI lower by $431,546 over 36 months). None of the above provides a reason for concluding that GOI's proposed costs are realistic. HUD's cost analysis only compared the two proposals on the same basis once, simply subtracting GOI's proposed cost from ATS's proposed cost. Such calculation does nothing to assure realistic costs, but merely shows the difference between the two proposers. The other comparison utilized GOI's current cost experience against ATS's ceiling costs (the most performance by ATS would cost the government). This does not result in a usable cost analysis because of the different basis used for each offeror. We note ATS argues that if its proposed costs are compared with GOI's current costs, ATS is almost $100,000 lower.

In view of the above, the question becomes whether imposition of caps on GOI's proposed direct and indirect costs can substitute for an adequate cost realism analysis. We can only condone such a substitution when it is clear that the cap imposed will protect the government to the same extent that an adequate analysis would. While HUD appears to have capped GOI's indirect costs, it is not clear that GOI's direct labor costs are effectively capped. The record shows that GOI initially resisted HUD's plan to impose caps. In fact, GOI warned HUD, at the time HUD began negotiating the cost ceilings, that imposition of the ceilings would prevent GOI from using the higher skilled personnel which HUD actually required to perform the work.

We are concerned that the cap imposed on GOI's direct labor is a cap on the average cost of a particular labor category. The average results from the combination of the salaries of all GOI personnel within the given category (both high salary and low salary). HUD does not appear to have determined exactly what skill mix and therefore what salary mix was represented by the average which GOI agreed to cap. We cannot conclude that such an arrangement will assure HUD of the availability of the necessary mix of personnel (high salary v. low salary) within a particular labor category to perform the contract.

Moreover, Article VIII of the contract grants GOI the right to reject a HUD task order in the event that GOI believes the prescribed work cannot be accomplished within the hours designated in the task order. Assuming that higher skilled, and presumably higher paid, contractor personnel can perform tasks at a higher speed, we think that a contractor, who submitted unrealistically low proposed costs, would be forced by the caps to propose less skilled, lower paid and slower personnel in order to stay within the ceilings. Consequently, it can be anticipated that such a contractor would reject task orders on the basis that more time was required for performance. In this regard we note that the ceilings on GOI's proposed costs are well below the costs that GOI is currently experiencing. Article VIII directs:

> "J. Immediately upon receipt of a rejected task specification, the Contracting Officer shall commence negotiations with the Contractor to resolve problems that made the task specification unacceptable. In the event no resolution on questions of fact can be obtained, the task specification in question may be subjected to General Provisions, Clause 13, entitled 'Disputes.'"

We think that HUD's substitution of caps for an adequate cost realism analysis is ineffective because, at best, it sets up a situation certain to generate endless disputes in the event that the contractor actually had submitted unrealistically low proposed costs.

Consequently, notwithstanding HUD's imposition of cost ceilings, we cannot find that HUD realized the cost safeguard's thought necessary by the SSO and the SEB. We think that a proper cost analysis is necessary in this kind of procurement.

As noted above, the SSO overruled the SEB and made award to the lower technically rated offeror, GOI, based on its lower cost proposal. We find, based on the above, that such action was not rationally based in view of the lack of a cost analysis and the inadequacy of the cost ceilings. However, there was also no adequate cost analysis performed on ATS. At this time, it is impracticable to attempt to conduct a proper cost analysis.

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Therefore, there was no assurance that award was made in the best interest of the government. In view of the stage of performance of the initial contract period and the time necessary to conduct a reprocurement, we recommend that the option not be exercised.

for Milton J. Socolar
Comptroller General
of the United States