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DECISION

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

FILE: B-220526.2 **DATE:** March 17, 1986

MATTER OF: Merret Square, Inc.

DIGEST:

1. Protest against the successful offeror's failure in its cost proposal to price separately annual rent and maintenance, under a solicitation for the construction and lease of military family housing units, is denied where the deviation did not operate to deprive the protester of an award to which it was otherwise entitled and had no significant adverse impact on the government's interest.

2. The concept of bid unbalancing generally is not relevant to a negotiated procurement in which cost or price is not the primary basis for source selection. Thus, the fact that the successful offeror under a solicitation for the construction and lease of military family housing units may have loaded an unknown amount for maintenance into its annual rent is immaterial where the basis for award was not the lowest total annual rent, but rather the most favorable cost/quality ratio between total annual rent and technical merit.

3. Whether the successful offeror under a negotiated procurement has sufficient financial backing to perform the contemplated effort directly relates to the firm's responsibility as a prospective contractor. By awarding the contract, the agency has in fact determined the firm to be responsible, and GAO does not review affirmative determinations of responsibility except in limited circumstances not present here.

4. Final negotiations with one offeror to obtain a small reduction in price were not improper where only that firm remained within the agency's revised competitive range.

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Merret Square, Inc., protests the award of a contract to Hunt Building Corporation under request for proposals (RFP) No. N62470-85-RP-00054, issued by the Department of the Navy. The procurement is for the construction and lease of military family housing units in the Norfolk, Virginia area. Merret principally complains that the award to Hunt is improper because Hunt's cost proposal deviated from a material requirement of the solicitation. We deny the protest.

Background

The procurement is pursuant to 10 U.S.C. § 2828(g) (Supp. I 1983), as added by section 801 of the Military Construction Authorization Act of 1984, which provides that the Secretary of a military department may enter into a contract for the lease of family housing units to be constructed on or near a military installation within the United States under the Secretary's jurisdiction at which there is a validated deficit in family housing. 10 U.S.C. § 2828(g)(1). Each contract must be awarded through the use of competitive procedures and may provide for the contractor to operate and maintain the housing facilities for the term of the lease, which is not to exceed 20 years. 10 U.S.C. § 2828(g)(2) and (4). No contract may be entered into until the Secretary of Defense submits to the appropriate committees of Congress a written economic analysis (based upon accepted life cycle costing procedures) demonstrating that the proposed contract is cost effective in comparison with alternative means of furnishing the same facilities. 10 U.S.C. § 2828(g)(6)(A).

The RFP contemplated the award of a contract for the construction of 300 family housing units which the contractor would then lease to the government at a fixed annual rate for a 20-year period, with maintenance and management of the units during the life of the contract provided by the contractor. The RFP called for a technical evaluation of the offeror's design, construction and maintenance plans. Cost proposals were evaluated on the basis of the annual combined shelter rent (lease) and maintenance rent over the anticipated 20-year period; shelter rent was required to remain the same for each year of the lease, but maintenance rent was allowed to increase to reflect inflation. The RFP expressly required offerors to price shelter and maintenance rent separately "to facilitate the Government's economic analysis." Further, offerors were required to submit with their proposals a copy of the financing commitments they had obtained for the project.

The underlying objective of the procurement was to determine whether contractor construction and lease of the units would be more cost effective than government construction. Accordingly, the RFP advised that an economic analysis would be prepared and submitted for congressional review. As stated in the RFP, \$25 million was the amount calculated by the Navy to represent the maximum life cycle net present value (LC-NPV) cost for the government construction alternative, and offerors were cautioned that any proposal with a total LC-NPV in excess of that amount would be rejected as nonconforming. For purposes of source selection, the total LC-NPV cost of each proposal was divided by the number of points the proposal received as the result of the technical evaluation.

The total LC-NPV cost of each proposal was determined by initially multiplying the proposed first-year shelter rent by a present dollar discount factor of 6.851 and the maintenance rent by a present dollar discount factor of 10.594. (The discount factor was higher for maintenance rent because this element is allowed to increase over the lease period because of inflation.) The two products were then combined to determine if the total LC-NPV of the proposal exceeded the \$25 million ceiling.

Hunt proposed a first-year shelter rent of \$3,649,000 and a first-year maintenance rent of \$0. Accordingly, the firm's total LC-NPV was determined to be \$24,999,299:

$$\begin{array}{lrcrcl} \$ & 3{,}649{,}000 & \times & 6.851 & = & \$\ 24{,}999{,}299 \\ \$ & 0 & \times & 10.594 & = & \underline{\$\qquad\qquad 0} \\ & & & \text{Total LC-NPV} & = & \$\ 24{,}999{,}299. \end{array}$$

When this figure was divided by 752, the number of technical evaluation points the Hunt proposal received, the cost/quality ratio of Hunt's offer was \$33,244 per point, the lowest among all offerors. Therefore, the Navy concluded that Hunt's offer was most advantageous to the government, and the firm was selected for the award.

In comparison, Merret proposed a first-year shelter rent of \$2,901,600 and a first-year maintenance rent of \$392,400, resulting in a total LC-NPV of \$24,035,947. Division of Merret's total LC-NPV by 636, the number of technical evaluation points the firm's proposal received, resulted in a cost/quality ratio of \$37,792 per point.

Merret contends that Hunt's offer was nonconforming to a material requirement of the RFP because Hunt failed to propose a separate price for maintenance rent. Merret urges that Hunt included maintenance rent within shelter rent for the express purpose of avoiding the $25 million cost ceiling. The protester calculates that if Hunt had proposed even a nominal first-year maintenance rent of $200, this figure, when multiplied by the applicable present dollar discount factor of 10.594, would have caused Hunt's total LC-NPV to exceed $25 million, thus requiring its rejection.1/

Merret asserts that it is unreasonable to assume that Hunt would provide maintenance for the number of units involved in the project at zero or even nominal cost, since the government's estimate for first-year maintenance was $300,000 (increasing to $600,000 a year for the rest of the lease period), and Merret's own first-year maintenance rent was $392,400, the lowest among all offerors. Merret believes that the only motivation for Hunt to offer zero maintenance rent was to hide its actual maintenance rent within the shelter rent so that the maintenance figure would not be subject to the higher discount factor multiplier of 10.594, thus mathematically avoiding a total LC-NPV exceeding the $25 million ceiling.

Merret also urges that Hunt's cost proposal is mathematically unbalanced because the firm's shelter rent includes an unknown amount for maintenance and, therefore, the shelter rent figure is artificially inflated and fails to reflect Hunt's actual costs for that element of its offer. Merret asserts that Hunt's cost proposal is materially unbalanced as well because Hunt's offer does not become lower than Merret's until the 16th year of the lease, even allowing Merret's first-year maintenance rent of $392,400 to increase 4 percent per year as a result of inflation, as contemplated by the solicitation. Therefore, Merret contends that the award to Hunt is not in the government's best economic interest since the lease may be terminated prior to the end of the 20-year period, and the government will have paid Hunt a higher amount than if the contract had been awarded to Merret.

In addition, Merret contends that the award to Hunt is improper because Hunt's financial institution has withdrawn

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1/ $ 3,648,800 x 6.851 = $ 24,997,928.80
$ 200 x 10.594 = $ 2,118.80

Total LC-NPV = $ 25,000,047.60

its backing for the project. Merret notes that the financial institution specifically withdrew its commitment because of differences with Hunt over basic business practices--differences Merret believes were directly related to the manner in which Hunt structured its cost proposal.

Finally, Merret asserts that Hunt was impermissibly allowed to reduce its offer by some 5 percent at the behest of the cognizant congressional committee reviewing the economic analysis of the Norfolk project submitted pursuant to 10 U.S.C. § 2828(g)(6)(A), supra. Merret notes that it also offered a substantial reduction in both its first-year shelter and maintenance rent, but that the Navy refused to entertain its offer because it had already selected Hunt for the award subject to final congressional approval. Merret believes that it was improper to conduct final cost negotiations with only Hunt.

Analysis

In Chrysler Corp., B-182754, Feb. 18, 1975, 75-1 CPD ¶ 100, upon which Merret relies, we held that bids were properly rejected where the protester's pricing structure reasonably indicated an intent to avoid a statutory price limitation. That case involved a congressionally mandated ceiling on the basic price of automobiles being procured for the government, a ceiling which did not extend to additional systems and equipment. The protester apparently sought to circumvent the statutory limitation by loading part of its basic vehicle prices into the prices for additional equipment, the latter of which were therefore artificially inflated. However, we believe that case is not controlling here. Unlike the matter in Chrysler, where only one bid element was subject to a price ceiling, the $25 million cost maximum at issue here applied to the total LC-NPV of the proposals, that is, to the shelter and maintenance rents in combination, and not to either item separately. Therefore, because only the "bottom line" LC-NPV figure determined whether a proposal exceeded the $25 million ceiling, we do not agree with the protester that our decision in Chrysler requires rejection of Hunt's proposal, despite the fact that Hunt may have deviated from the RFP requirement to price the two rent elements separately.

Furthermore, this deviation works no competitive prejudice to Merret because, even if Merret had been allowed to load all of its maintenance rent into its shelter rent as Hunt allegedly did, the firm's proposal still would not have obtained a cost/quality ratio superior to Hunt's. By way of illustration, if Merret's first-year maintenance rent of $392,400 is added to its first-year shelter rent of $2,901,600, the resulting total of $3,294,000, when multiplied by the discount factor of 6.851, yields a total LC-NPV of $22,567,194. If this figure is then divided by Merret's technical score of 636, the firm's cost/quality ratio, the basis for award, is still higher than Hunt's ($35,483 versus $33,244). Thus, even if we were to conclude that the Navy acted improperly by not requiring Hunt to price its shelter rent and maintenance rent separately, this does not provide a basis to sustain the protest because the deficiency did not operate to deny Merret an award to which it was otherwise entitled. See Lingtec, Inc., B-208777, Aug. 30, 1983, 83-2 CPD ¶ 279.

Moreover, we do not believe that the manner in which Hunt structured its cost proposal has any significant adverse effect upon the government's interest. In this regard, by not separately pricing its maintenance rent, Hunt's offer is not subject to any allowable increase due to inflation and Hunt bears the risk that its fixed annual shelter rent does not sufficiently cover the costs for increased maintenance over the life of the lease because of inflation. It is true, as Merret emphasizes, that the lease agreement provides that maintenance rent also is subject to deflation, and that the maintenance rent may be decreased at the government's option to reflect the contractor's decreased costs in maintaining the units. However, we do not believe the fact that the government will not be able to enjoy such reductions in the future because Hunt's offer is fixed at its annual shelter rent required the agency to reject Hunt's offer. The RFP generally contemplates that maintenance rent will continue to increase over the life of the lease because of inflation. In this regard, we note that the RFP specifically provides that maintenance rent "will be allowed to escalate at a rate pegged to the 'Economic Indicators' prepared . . . by the Council of Economic Advisors . . . (currently approximately 4 percent)." In addition, as previously noted, the discount factor for maintenance rent used in evaluating the cost proposals was adjusted for inflation.

We also note that even though the RFP provides that repair costs shall be negotiated annually between the government and the contractor and shall be adjusted at the same rate and time as maintenance rent, Hunt bears a greater burden because it seemingly has precluded itself from any upward adjustment in those costs by not pricing a separate maintenance rent. Similarly, by not providing a separate maintenance rent, Hunt has also precluded itself from receiving an incentive fee award for exceptional performance of maintenance services. (As provided for in the RFP, the contractor's entitlement to such an award will be determined on an annual basis in an amount not to exceed 5 percent of the maintenance rent.)

In sum, Hunt's failure to price maintenance rent separately did not prejudice any other offeror and does not have an inherently adverse impact on the government's interest. In our view, the only party potentially harmed by this deviation to any significant extent is Hunt itself, since the firm will not be entitled to any price adjustments during the course of the lease due to expected inflation.

We also find no merit in the protester's assertion that Hunt's proposal is both mathematically and materially unbalanced.2/ Although we have recognized that the concept of unbalancing may apply in limited circumstances to negotiated procurements, see TLM Berthing, Inc., B-220623, Jan. 30, 1986, 86-1 CPD ¶ ___, it is only relevant where cost or price constitutes a primary basis for source selection. In that situation, the fact that one element of a cost proposal carries a significantly disproportionate share of the total cost of the work plus profit so as to be mathematically unbalanced may create a reasonable doubt that an award will ultimately result in the lowest overall cost to the government. Id.

However, in the present matter, lowest total LC-NPV cost was not determinative as to award, but rather award was based on the ratio between LC-NPV cost and the number

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2/ Generally, unbalanced bidding entails two aspects. The first is a mathematical evaluation of the bid or offer to determine whether each item carries its share of the cost of the work plus profit, or whether the bid or offer is based on nominal prices for some work and enhanced prices for other work. The second aspect--material unbalancing--involves an assessment of the cost impact of a mathematically unbalanced bid. A bid is materially unbalanced if there is a reasonable doubt that the award will result in the lowest ultimate cost to the government. Applicators, Inc., B-215035, June 21, 1984, 84-1 CPD ¶ 656. In addition, a bid or offer that is mathematically unbalanced in the extreme should be rejected, even if low, since it suffers from the same defect as an advance payment. Edgewater Machine & Fabricators, Inc., B-219828, Dec. 5, 1985, 85-2 CPD ¶ 630.

of technical evaluation points a proposal received. Thus, an offeror proposing a higher total combined rent over the life of the lease (discounted to present dollars) could be eligible for the award if the cost premium were offset by a higher technical score. This is a classic example of a negotiated procurement in which the contracting agency, consistent with stated evaluation criteria, makes a reasoned tradeoff between cost and technical merit to determine the most advantageous offer. See Grey Advertising, Inc., 55 Comp. Gen. 1111 (1976), 76-1 CPD ¶ 325. Hunt's proposal was selected for award because the technical quality of its proposal in terms of the design and construction of the housing units overcame the higher premium the government would have to pay in leasing the units from Hunt over the 20-year period. Since ultimate cost was not the paramount basis for source selection, we think it immaterial that Hunt's proposal, by loading unknown maintenance costs into shelter rent, arguably may have been mathematically unbalanced.

Moreover, we do not believe that Hunt's offer is so extremely front-loaded that Hunt will receive funds in the early years of the lease far in excess of the amount it would be entitled to if payment were measured on the basis of actual value received. See Edgewater Machine & Fabricators, Inc., B-219828, supra n.2. In Edgewater, we recognized that an extremely front-loaded offer suffers from the same evil as an advance payment and is merely a device to obtain unauthorized contract financing. Id. at 4. In this situation, however, although Hunt may have included maintenance rent within its shelter rent, the cost of maintenance to be provided in each year of the lease will be compensated directly from the fixed shelter rent. Therefore, we do not believe that Hunt's cost proposal structure represents gross front-loading within the meaning of Edgewater since the measure of reimbursement remains the same throughout the life of the lease.

We also find no merit in the protester's assertion that an award to Hunt is improper because its financial backer withdrew its commitment for the project. Although it is true that, after receipt of best and final offers, the financial institution in question expressly withdrew its commitment because of business differences with Hunt, this institution subsequently advised Hunt prior to award that it would be willing to work out an agreement with the firm to finance the project. Despite whatever difficulties that may have arisen after Hunt submitted its proposal, the record shows that Hunt's proposal included a copy of the original financial commitment and, therefore, the firm clearly complied with the RFP's requirement that each offer include a copy of the financing commitment obtained.

Moreover, contrary to Merret's assertion, we do not believe that the withdrawal of this commitment after receipt of best and final offers rendered Hunt's proposal unacceptable. In our view, the question of whether Hunt has sufficient financial backing for the project directly involves the firm's responsibility as a prospective contractor. By awarding Hunt the contract, the Navy has in fact determined that Hunt is responsible. See the Federal Acquisition Regulation (FAR), 48 C.F.R. § 9.105-2(a)(1) (1984); Ameriko Maintenance Co., B-216247, Sept. 12, 1984, 84-2 CPD ¶ 287. This Office does not review affirmative determinations of responsibility absent a showing of possible fraud or bad faith on the part of procuring officials or an allegation that definitive responsibility criteria were misapplied. Ameriko Maintenance Co., B-216247, supra, 84-2 CPD ¶ 287 at 2. Merret has made no attempt to show that the Navy acted in bad faith in determining Hunt to be responsible to perform the contract and, even if the solicitation's requirement for a financial commitment could be construed as a definitive responsibility criterion, Hunt apparently still has that commitment. Accordingly, we find no basis to question the Navy's selection of Hunt for the award even though there may have been some difficulties surrounding its financial backing for the project.

Finally, Merret contends that the award is improper because, at the behest of the House Committee on Appropriations, the Navy sought and obtained a 5-percent price reduction from Hunt, but refused to entertain a similar offer from Merret. Merret urges that the committee expressly directed the Navy to seek a price reduction by renegotiating with "current bidders," which Merret argues necessarily included itself. Merret contends that the Navy therefore acted improperly by not considering the firm's offer to reduce its annual shelter rent and maintenance rent, respectively, to $2,445,259 and $384,000. We do not accept the firm's argument.

The facts reveal that, after the Navy selected Hunt for the award, the committee advised the Department of Defense (DOD) by letter of December 4, 1985, that it had reviewed the economic analyses submitted by DOD for proposed family housing contracts at three installations.

One of these involved the Navy's Norfolk project, and the other two involved construction and lease of units at Army installations. The committee found the proposed costs for the Norfolk project and for one of the Army's projects to be too high. Accordingly, the committee expressly directed DOD "to take whatever steps are necessary to reduce the costs of these projects including re-negotiation with current bidders or re-bidding them."

By subsequent letter of December 13, after the Navy had apparently sought an initial price reduction from Hunt, the committee directly advised the Navy that, "After reviewing the results of the renegotiation with the contractor, the Committee still feels its cost is too high." The committee reminded the Navy that its options of either "renegotiation or rebidding remain." The Navy was then able to obtain a 5-percent price reduction from Hunt, and the committee consequently approved the Norfolk project.

It is a fundamental principle of federal procurement law that if, after receipt of best and final offers, an agency deems it to be clearly in the government's interest to reopen negotiations, it must reopen negotiations with all offerors still within the competitive range and request additional best and final offers. FAR, § 15.611(c) (FAC 84-5, Apr. 1, 1985); <u>see also</u> <u>Mayden & Mayden</u>, B-213872.3, Mar. 11, 1985, 85-1 CPD ¶ 290. Therefore, the question to be resolved is whether Merret remained within the competitive range at the time the Navy reopened negotiations with Hunt--that is, whether the Navy still viewed Merret as having a reasonable chance of being selected for award. <u>See</u> <u>Information Systems & Networks Corp.</u>, B-220661, Jan. 13, 1986, 86-1 CPD ¶ ___.

In this regard, we have held that there is nothing improper <u>per se</u> in an agency's making more than one competitive range determination and in dropping a firm from further award consideration, so long as the firm's exclusion was ultimately justified. <u>See</u> <u>BASIX Controls Systems Corp.</u>, B-212668, July 2, 1984, 84-2 CPD ¶ 2. Although the Navy has not characterized its action here as a competitive range revision, we believe this is what essentially occurred. As already noted, Merret's technical proposal received a quality rating significantly inferior to Hunt's, a percentage difference between the scores of some 18 percent. Even though Merret's total LC-NPV cost was lower than Hunt's by some 4 percent, it is apparent that the Navy had ultimately concluded that Merret's technical proposal was not amenable to meaningful improvement through further negotiations so as to have any possibility of becoming the more advantageous offer. Thus, relative to Hunt's much higher technical score and consequently superior cost/quality ratio, Merret was no longer considered to have a reasonable chance of receiving the award, a determination tantamount to a competitive range justifiably revised to include only one offeror. See Information Systems & Networks Corp., B-220661, supra. Accordingly, we cannot object to the Navy's action in holding final competitive range negotiations with Hunt to obtain a small reduction in price. Id.

The protest is denied.

Harry R. Van Cleve

Harry R. Van Cleve
General Counsel