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Comptroller General
of the United States

Washington, D.C. 20548

Decision

Matter of: Hudson Bay Natural Gas Corporation

File: B-237264

Date: February 5, 1990

Scott H. Robb, Esq., Robb & Henning, for the protester.
Colonel Herman A. Peguese, Chief, Contract Support Division, Department of the Air Force, for the agency.
Ann Perry, Esq., Paul Lieberman, Esq., and John F. Mitchell, Esq., Office of the General Counsel, GAO, participated in the preparation of the decision.

DIGEST

Protest against the application of the small disadvantaged business evaluation preference to only the cost adjustment factors in a procurement for natural gas is denied where the method employed constitutes a reasonable application by the Air Force of the 10 percent preference called for under its regulations, to a contract which incorporates index pricing, by limiting the preference to those portions of the contract which are actually priced by the offerors, and for which the amount paid does not fluctuate.

DECISION

Hudson Bay Natural Gas Corporation protests the award of a contract to Mountain Iron and Supply Company under request for proposals (RFP) No. F23606-89-R-0005, issued by the Department of the Air Force for natural gas for both Whiteman and McConnell Air Force Bases. Hudson Bay contends that the Air Force improperly applied the solicitation's small disadvantaged business (SDB) evaluation preference, and that if the preference is calculated correctly, Hudson Bay, a qualifying SDB, is the low responsible offeror.

We deny the protest.

The solicitation, issued June 1, 1989, set forth estimated quantities of natural gas to be used on the two Air Force bases for a base year and for 4 option years. The bidding schedule required offerors to enter prices only for the

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supply adjustment factor (SAF) and for the transportation adjustment factor (TAF). The SAF consists of the amount above or below the index price cited in Inside FERC's Gas Market Report1/ the contractor will charge for the gas. The TAF is the amount above or below the Federal Energy Regulatory Commission (FERC) approved tariff, for the pipeline serving the local gas utility, that the contractor will charge for transporting gas. These adjustment factors can be characterized as the supplier's controllable profit margin, which is added to the monthly "Inside FERC price" for the natural gas. The solicitation provided that the amount to be paid to the contractor would be calculated on the basis of reimbursement of the index price for the month, plus the adjustment factors; in other words, a fluctuating price. The solicitation further provided that award of the contract would be made to the technically qualified, responsible offeror whose proposal offered the lowest total price for both locations. The solicitation called for application of the SDB preference, as provided for under the Air Force Federal Acquisition Regulation Supplement (AFARS) § 52.219-7007, which provides that if the apparent low offeror is not an SDB, then this low price is to be increased by 10 percent, and if this makes it higher than any SDB's offer, then the award is to be made to the low SDB.

Several proposals, from large, small, and small disadvantaged businesses, were received by the July 5, 1989, closing date. The low offeror was Mountain Iron and Supply Company, a large business, with a total adjustment factor price of $125,450.50 over the 5-year period. Hudson Bay's price was $379,010. When the contracting officer increased Mountain Iron's price by 10 percent it was not displaced by an SDB and, therefore, award was made to Mountain Iron on September 19. Hudson Bay filed an agency-level protest on October 2, and the next day filed a protest in our Office.

Hudson Bay contends that the evaluation of the proposals was inaccurate because the 10 percent preference given to SDBs was applied improperly. The protester argues that it was improper to apply the 10 percent preference to only the adjustment factors rather than to the entire contract value,

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1/ Inside FERC's Gas Market Report is a private publication which averages the spot market cost of gas to commercial users each month and publishes the resulting amount, adjusted to reflect the applicable transportation tariffs, as a monthly index price referred to as the "Inside FERC price."

adjustment prices plus the index price of the natural gas. Hudson Bay contends that if the 10 percent preference is applied to the total contract value, then its offer is lower than the large business awardee's offer. Hudson Bay arrives at this conclusion by using the unit index price on the date of receipt of proposals which was $1.33. Hudson projects the first year value of the natural gas contract as $785,096, and over a 5-year period it values the contract at approximately $4,612,967 in 1989 dollars.2/ Based on these projected values, Hudson argues that the SDB preference should have been $78,509 in the first year and $461,296 for all 5 years. The SDB preference actually used by the Air Force was $12,540, based only on the adjustment factors. Use of the $461,296 as the preference figure would displace Mountain Iron as the low offeror.

The Air Force argues that although under its method of calculation a lesser amount is applied as the SDB preference, it is the most appropriate method available. The Air Force asserts that its method of evaluating only the adjustment factors is a good faith attempt to apply the SDB preference to a contract utilizing index prices. The agency explains that the only competitive features of the solicitation are the adjustment factors since the natural gas price is established by Inside FERC. The Air Force contends that its evaluation of only the adjustment factors is the only feasible calculation which may be performed accurately since the index price changes monthly, and it is impossible to forecast with certainty what the contract price will be for the 5-year life of the contract. The Air Force believes that calculating 10 percent of an unknown and fluctuating figure would not provide a meaningful preference evaluation.

In addition, the Air Force contends that the problem is compounded by the fact that an SDB will probably be aware of the current monthly index price at the time it submits an offer. As a result, an SDB can offer an adjustment price based on the 1 month Inside FERC price which will be within the 10 percent range, guaranteeing that it will displace all non-SDBs, but without there being any real assurance that the price being used for the preference calculation will bear any meaningful relation to the actual contract price. Indeed, it is precisely because of the pricing volatility

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2/ These figures are arrived at by multiplying the annual estimated volume MMBtu (million British thermal units) required under the RFP by the Inside FERC prices on September 15, 1989, and by adding Mountain Iron's adjustment factors for the same volume.

and fluctuations that the index pricing method is being utilized for this procurement.

We believe that the Air Force's application of the SDB preference in the context of a contract using index pricing constitutes a reasonable interpretation of the AFARS, by attempting to balance the uncertainties of the future contract costs with the preference to which SDBs are entitled in competing for natural gas contracts.3/ We find that applying the 10 percent preference only to the adjustment factors, as the only stable elements of price and the only elements priced by the offerors, and on which they compete, is a reasonable means of addressing these concerns. The index prices are uniformly applied as essentially a pass-through amount which is beyond the offerors' control, and is not a part of the line item price calculations which are used to determine the low offeror. Contrary to the protester's arguments, applying the 10 percent preference to the then-current Inside FERC price of the natural gas as well as to the adjustment factors is extremely speculative and cannot account for the fact that if the price of natural gas decreases the "winning" SDB's offer may no longer be "low," and the price paid may exceed the congressional limitation of 10 percent over fair market value.

3/ The 10 percent evaluation preference is established by Department of Defense regulations which were issued to implement section 107 of the National Defense Authorization Act for FY 1987, Pub. L. No. 99-661, 100 Stat. 3978 (1986), and section 806 of the Department of Defense Authorization Act for FYs 1988 and 1989, Pub. L. No. 100-180, 100 Stat. 1020, 1126 (1987). These acts require DOD to seek to award 5 percent of the total dollar value of its contracts to SDBs. The acts do not provide for application of the evaluation preferences, or any other specific means for attaining the 5 percent goal. The acts admonished the Secretary of Defense to "exercise his utmost authority, resourcefulness and diligence" to attain the 5 percent goal and permit use of less than full and open competitive procedures to do so, provided that contract prices do not exceed fair market value by more than 10 percent.

Accordingly, we find that the agency's evaluation methodology reasonably implements the SDB preference provided for under its regulations.

The protest is denied.

Seymour Efros

for James F. Hinchman
General Counsel