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Comptroller General
of the United States

Washington, D.C. 20548

Decision

Matter of: Vitro Corporation

File: B-247734.3

Date: September 24, 1992

William L. Walsh, Jr., Esq., J. Scott Hommer, III, Esq., and William Craig Dubishar, Esq., Venable, Baetjer and Howard, for the protester.
W. Jay DeVecchio, Esq., Robert M. Halperin, Esq., and Stephanie B.N. Renzi, Esq., Crowell & Moring, for RGE Engineering Services Company, an interested party.
Veronica Murtha, Esq., and D.H. Beck, Department of the Navy, for the agency.
Ralph O. White, Esq., and Christine S. Melody, Esq., Office of the General Counsel, GAO, participated in the preparation of the decision.

DIGEST

1. Contention that agency performed an unreasonable cost realism review by accepting a very low cap on awardee's general and administrative (G&A) expenses and overlooking the effect of a "loophole" in the cap is denied where agency retained adequate controls over the alleged loophole to prevent its use to avoid the G&A cap.

2. Contention that agency cost realism analysis was improper for failing to identify direct and indirect cost pools where single-contract joint venture awardee might allocate general and administrative-type costs, and as a result, overcome any benefit of a negotiated cap on such costs, is denied where the agency acknowledges that the costs will be allocated as protester claims but shows that it reviewed the costs and reasonably considered their realism.

DECISION

Vitro Corporation protests the award of a contract to RGE Engineering Services Company by the Department of the Navy pursuant to request for proposals (RFP) No. N00024-90-R-5601(Q), for engineering services support for shipboard combat systems and command and control systems. Vitro argues that the Navy's cost realism analysis of RGE's proposal was flawed in several respects, and that, as a result, the decision to select RGE for award because of its lower proposed costs was unreasonable. In addition, Vitro

argues that the Navy gave preferential treatment to RGE during the course of the procurement.

We deny the protest.

BACKGROUND

The Navy issued this RFP more than 2 years ago, on August 30, 1990, seeking offers for engineering services support at a level of 104,640 mandays per year for 1 base year and 4 option years. The RFP anticipated award of a cost-plus-award-fee contract to the offeror whose proposal was determined most advantageous to the government.

The RFP advised potential offerors that technical merit was more important than an offeror's proposed cost; however, the RFP also included detailed comments on the significance of proposed costs in the agency's evaluation scheme. In this regard, the RFP, section M, paragraph I, stated:

> "Offerors are advised that while technical is more important than cost, the Government is not willing to pay an excessive amount for technical superiority. Cost is also an important consideration. Accordingly, award will not necessarily be made to that offeror whose proposal receives the highest score for technical factors, nor will award be made necessarily to the technically acceptable low offeror. The Government may determine that the margin of technical superiority is not worth the additional cost."

The Navy received four offers in response to the RFP, including the offers from Vitro and RGE.[1] Upon review of the initial proposals, the Contract Award Review Panel recommended that the Navy include only the Vitro and RGE proposals in the competitive range, since both companies received weighted technical scores in the outstanding range. The other two offerors received much lower scores.

In reviewing the Vitro and RGE proposals, the review panel noted that while both offerors received very high technical scores, RGE's proposed costs were significantly lower than those proposed by Vitro. Despite the cost savings of the RGE proposal, the review panel concluded that it could not meaningfully compare RGE's proposed costs with the prior costs of performance incurred by the incumbent, Vitro. As a

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[1]Vitro is the incumbent here, while RGE is a joint-venture formed by Raytheon Service Company and General Electric Government Services, Inc. (GE) for the limited purpose of performing this contract.

result, the Navy's initial review concluded that RGE's cost proposal was the least reliable of all four offers, and that award to RGE would present the greatest risk of a cost overrun. On the other hand, since RGE's initial technical proposal was rated outstanding, and since its initial proposed costs were more than $33 million lower than those of the incumbent, the review panel decided to hold discussions and attempt to ascertain the most likely cost of RGE's proposal.

The review panel recognized that its difficulty analyzing RGE's cost proposal was caused by an important difference between RGE and Vitro--i.e., RGE's status as a single-contract joint venture meant it could properly allocate support costs directly to the contract, and not allocate all such costs as overhead, as is the case with a multiple-contract business entity like Vitro.[2] Since the panel also recognized that the incumbent's prior actual costs were probably the agency's single most useful source of comparison, it asked RGE to change its method of allocating costs in its proposal in order to improve the Navy's ability to compare RGE's and Vitro's proposed costs. The Navy apparently believed that reviewing a revamped proposal--with costs allocated more similarly to the method of allocation used by the incumbent--would increase its confidence that RGE was realistically anticipating necessary costs.

During negotiations the panel also took another step to allay its concerns about the realism of RGE's proposal: it decided to accept a cap[3] on RGE's G&A expense rate. To implement the cap, the Navy and RGE negotiated an explanatory clause defining the applicability of RGE's G&A cap. Among other things, the negotiated clause defined RGE's G&A as a limited expense pool to be comprised only of state

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[2]Federal Acquisition Regulation (FAR) § 31.203 defines an indirect cost as "any cost not directly identified with a single, final cost objective, but identified with two or more final cost objectives or an intermediate cost objective." Since a single-contract joint venture, by definition, could arguably have only one final cost objective, such an entity could conceivably have no indirect costs--i.e., overhead--and no general and administrative (G&A) expenses, since all costs are appropriately allocated directly to the performance of the contract. See also FAR § 31.202.

[3]We will not disclose the precise percentage of the cap based on RGE's assertion that that information is proprietary.

income taxes, general management support, and bid and proposal expenses. The clause defined general management support as:

> "[A] prorata share of Raytheon Service and GE Government Service Companies' President, Vice President, and Controller expenses. This support also includes each company's respective costs for annual audits, financial consolidation and accounting support, and professional support such as Human Resources, Contracts, Purchasing, and Information Processing Systems."

In addition, the clause explained that RGE's G&A cap was applicable to RGE effort only, and not to efforts attributed to the parent companies. Specifically, the clause states:

> "This agreed to G&A expense rate ceiling or cap is applicable to the RGE effort only and does not apply to the G&A Expense rates of interdivisional transfer efforts by Raytheon Service or GE Government Service Companies."

On November 22, 1991, the Navy received best and final offers (BAFO) from RGE and Vitro. After final evaluation of the technical and cost proposals, the review panel concluded that while both offerors continued to merit outstanding technical scores, RGE's proposed costs were much lower than those of Vitro. The final technical scores and the proposed and projected costs were as follows:

Offeror	Technical Score	Proposed Cost	Projected Cost
RGE	89.66	$118,512,488	$124,997,775
Vitro	97.94	151,232,562	151,921,413

As a result, on December 30, the review panel recommended that the contracting officer select RGE for award on the basis that the 8 percent margin of technical superiority offered by the Vitro proposal was not worth the 21.5 percent, or approximately $27 million, difference in projected costs. Award was made to RGE on January 16, 1992.

PROTESTER'S ARGUMENTS AND PROCEDURAL ISSUES

Vitro's initial protest to our Office raised numerous issues. Vitro complained that the Navy: (1) conducted an unreasonable cost/technical tradeoff; (2) failed to hold adequate discussions; (3) engaged in impermissible technical leveling; and (4) conducted an improper cost realism analysis by failing to reject RGE's proposal for offering an unreasonably low cap on certain proposed costs, and for

failing to consider the effect of an alleged "loophole" in the proposed cap. However, for the reasons explained below, Vitro's initial protest was largely untimely.

When the Navy made award to RGE, Vitro was given oral notice the same day, and received written notice on January 21. On January 23, Vitro received a debriefing from representatives of the Navy. At this time, the Navy representatives explained in detail the basis for selecting RGE over Vitro, even though Vitro's proposal received a higher technical score. In addition, Vitro was advised during the debriefing that RGE had proposed a cap on its G&A rate, and that the cap was limited to RGE's efforts--i.e., did not apply to interdivisional transfers of effort from either of the two parent companies to the joint venture. In fact, after the debriefing--but on the same day--Vitro was given a copy of the text of the clause capping RGE's G&A. Vitro was not, however, advised of the amount of RGE's G&A cap, as the actual rate was considered proprietary to RGE and was redacted from the clause.

After the debriefing, Vitro submitted a Freedom of Information Act (FOIA) request for the entire text of the contract awarded to RGE. On February 11, the Navy responded to the FOIA request by providing the text of the contract. When it did so, the Navy inadvertently failed to redact RGE's G&A rate. Thus, on February 11, Vitro learned the precise percentage at which RGE proposed to cap its G&A expenses, and on February 26, Vitro filed this protest.

In response to Vitro's protest, the Navy filed a Motion for Summary Dismissal, asking our Office to dismiss the protest as untimely since it was filed more than 10 days after Vitro's debriefing. Since our Bid Protest Regulations require filing within 10 days after the basis for protest is known, 4 C.F.R. § 21.2(a)(2) (1992), we granted the request, in part. In our view, since the basis for every argument Vitro raised--with the sole exception of its challenge to the size of the G&A cap--was known to Vitro more than a month before the protest was filed, most of the issues in Vitro's initial protest were untimely raised. Thus, we concluded that the only timely issues presented in Vitro's initial protest were whether accepting RGE's G&A cap was reasonable, and whether, given the very low rate of the cap, the Navy adequately considered the possibility that RGE may have created a loophole limiting its applicability.[4]

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[4]Although the Navy correctly pointed out that Vitro became aware of the so-called loophole in RGE's G&A cap at the debriefing, Vitro argues it was not on notice of the possible importance of the loophole until it became aware of RGE's "astonishingly low" G&A rate.

The Navy submitted a full report on the protest on April 7, and supplemented its report on April 24. Upon receipt of the Navy's reports, Vitro filed a supplemental protest renewing its claims that the Navy's cost realism analysis was unreasonable. In its supplemental protest, Vitro argues that the Navy: (1) conducted an improper cost realism analysis because it misevaluated certain "loopholes" which will permit RGE to recover all of its G&A-type costs in other areas, (2) made an unsupported cost/technical tradeoff decision because of the flaws in its cost realism analysis, and (3) gave preferential treatment to RGE by deleting a solicitation clause on executive compensation at RGE's request.

This decision considers the timely issues remaining in the initial protest, and the issues raised in Vitro's supplemental protest filed within 10 days of Vitro's receipt of the agency report on the initial protest.

ANALYSIS

Vitro's challenges to the Navy's cost realism analysis relate to agency reviews of cost proposals submitted by single-contract joint ventures, and cost proposals with caps imposed on certain cost pools. As Vitro sees it, the Navy's review of RGE's proposed costs here failed to grasp all the issues relating to this unique environment, and caused the Navy to perform a flawed cost realism analysis of RGE's proposal.

As with any evaluation for the award of a cost-reimbursement contract, an offeror's proposed estimated costs are not dispositive, because regardless of the costs proposed, the government is bound to pay the contractor its actual and allowable costs. FAR § 15.605(d). Consequently, a cost realism analysis must be performed by the agency to determine the extent to which an offeror's proposed costs represent what the contract should cost, assuming reasonable economy and efficiency. CACI, Inc.-Fed., 64 Comp. Gen. 71 (1984), 84-2 CPD ¶ 542. Because the contracting agency is in the best position to make this cost realism determination, our review of an agency's exercise of judgment in this area is limited to determining whether the agency's cost evaluation was reasonably based and not arbitrary. General Research Corp., 70 Comp. Gen. 279 (1991), 91-1 CPD ¶ 183, aff'd, American Mgmt. Sys., Inc.; Dept. of the Army--Recon., 70 Comp. Gen. 510 (1991), 91-1 CPD ¶ 492; Grey Advertising, Inc., 55 Comp. Gen. 1111 (1976), 76-1 CPD ¶ 325.

Vitro's Initial Challenge to RGE's G&A Cap

In its initial protest, Vitro argues that it was unreasonable for the Navy to accept RGE's G&A cap, and that, given

the very low rate of the cap, the Navy did not adequately consider the effect of excluding interdivisional transfers of effort from the applicability of the cap. In short, Vitro claims that the Navy left for RGE an escape hatch from the cap--i.e., the option of shielding some unknown portion of the contract effort from the coverage of the cap on G&A by using the parent companies to supplement RGE's performance. Therefore, Vitro claims that by failing to consider the amount of work to be performed by the parent companies, the Navy failed to conduct a reasonable cost realism analysis.

The Navy argues that when an offeror agrees to cap its G&A costs in a cost-reimbursable contract, an agency's responsibility to perform a cost realism analysis of the capped costs is very limited. The Navy points to our decision in Robocom Sys., Inc., B-244974, Dec. 4, 1991, 91-2 CPD ¶ 513, to support its contention that, given the cap, it was not required to review RGE's G&A costs beyond considering whether acceptance of the cap would affect RGE's responsibility as a contractor. In addition, the Navy claims that under the rationale of our decision in Resource Consultants, Inc., B-245312.2, Mar. 23, 1992, 92-1 CPD ¶ 301, any upward adjustment to RGE's G&A costs would have been improper.

As a general rule, the maxim that the government bears the risk of cost overruns in the administration of a cost-reimbursement contract is reversed when a contractor agrees to a cap or ceiling on its reimbursement for a particular category or type of work. Advanced Tech. Sys., Inc., 64 Comp. Gen. 344 (1985), 85-1 CPD ¶ 315. As a result of shifting this risk, when offerors propose such caps, and no other issue calls into question the effectiveness of the cap, upward adjustments to capped costs are improper. Compare Resource Consultants, Inc., supra (agency's upward adjustment of capped G&A expenses was improper but did not invalidate the cost/technical tradeoff decision because the impact was negligible) with Advanced Tech. Sys., Inc., supra (cap on direct costs was not an adequate substitute for a cost realism analysis where the record indicated that the cap might be ineffective at limiting such costs). Whether an awardee will be able to perform a contract at rates capped below actual costs falls within an agency's determination of an offeror's affirmative responsibility, a determination we will not review absent a showing of agency fraud, bad faith or misapplication of definitive responsibility criteria. Robocom Sys., Inc., supra.

While Vitro challenges both the size of the cap--calling it "astonishingly low"--and the so-called loophole, we consider Vitro's first issue analogous to a protester's claim that an offeror has submitted a below-cost offer in a fixed-cost environment. Since a cap, by definition, converts at least

some portion of a cost-type contract to a fixed-price contract, see Advanced Tech. Sys., Inc., supra, the only issue raised by the size of a cap is whether the offeror will be able to perform at, or below, the rate promised. Since an offeror's ability to perform as promised falls within an agency's assessment of responsibility, and there is no allegation or evidence of bad faith, fraud, or misapplication of definitive responsibility criteria, this issue is not for review by our Office. See Robocom Sys., Inc., supra.

With respect to Vitro's second challenge--that the cap contains a loophole that renders it meaningless--Vitro correctly argues that the Navy could not rely solely on the existence of the cap as protection against recovery by RGE of costs via the so-called "loophole" of interdivisional transfers of effort to its parent companies. This is because the Navy was faced with a capping provision that might permit recovery, outside of the cap, of certain costs that otherwise would be expected to be subject to the cap. See Advanced Tech. Sys, Inc., supra. For the reasons explained below, however, we find that, in addition to the cap, the Navy retained sufficient control over RGE to protect the government from the cost overruns Vitro predicts.

RGE represented in its BAFO that it would perform 98 percent of the work itself, and would only use its parent companies to perform 2 percent of the work. To the extent that RGE attempts to increase the amount of effort performed by the parent companies, the Navy, in administering the contract, can hold RGE to the terms of its proposal. The Navy negotiated specific controls helpful in this regard. These controls should provide diligent agency administrators with the tools necessary to minimize shifts of parent company costs into the joint venture's cost pools that Vitro claims will occur. For example, the contract at clause H-3, entitled "Tasking Controls," anticipates issuance of technical instructions for each task required of the contractor. Upon receipt of the technical instructions, the contractor is to provide the Navy with a report detailing the contractor's intended approach, including an estimate of all costs to be incurred and any proposed subcontract effort. If the Navy agrees, it directs the contractor to proceed.[5] With this approach, the Navy should be constantly aware of performance costs and be able to control the kind of misallocation of costs about which Vitro warns.

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[5]By withholding agreement to proposed performance approaches submitted by the contractor, the Navy can limit, in advance, the kind of subcontract costs about which Vitro is concerned.

Also, the Joint Venture Agreement submitted as part of RGE's proposal requires that work performed for the joint venture by the parent companies be performed pursuant to subcontracts. Since the Navy retains control over the award of such subcontracts, the Navy will be in a position to control the amount of subcontracting ("interdivisional transfers") between the joint venture and its parents.[6]

Moreover, the Navy's evaluation of RGE's proposal resulted in a finding that the proposed approach was outstanding. Since this procurement is essentially for services--i.e., people, and an organization supporting those people--the technical evaluation conclusion supports heightened comfort by the Navy that RGE will be able to perform as it has proposed. There is nothing in the record to suggest that RGE will attempt to abandon its stated approach to performing these services. Nor will we assume that an offeror will propose one course of action, and pursue another, in a bad faith attempt to shift costs from a capped overhead account to a direct labor account to circumvent the cap and increase recoverability. Robocom Sys., Inc., supra.

In short, we find that the Navy reasonably concluded it had the tools necessary to prevent RGE from recovering capped G&A-type costs via interdivisional transfers of effort to its parent companies.

Vitro's Supplemental Challenge to RGE's G&A Cap

In its supplemental protest, Vitro pursues the Navy's cost realism analysis of RGE's G&A in the opposite direction--instead of claiming that G&A-type costs will percolate upwards to the parents of the joint venture, Vitro's supplemental protest claims such costs will trickle down

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[6]These specific contract provisions are in addition to general constraints available to the agency if RGE attempts to recover a greater share of its costs via interdivisional transfers of effort. There are four 1-year options appended to this contract. If during the course of performance RGE tries to place more work with its parent companies than represented in its proposal--thus circumventing the cap on G&A--the Navy could seek new proposals rather than exercise its options. The Navy can also protect its interests with the requirement, found at FAR § 31.201-2, that all costs charged to the government be reasonable, allocable, allowable, and consistent with the cost principles set forth in FAR part 31; and the fact that cost reimbursable contracts are subject to audit, pursuant to FAR § 52.215-2, to protect the government against improper cost substitution by contractors.

into direct and indirect cost pools where they will be easily recovered from an unsuspecting agency.

In this regard, Vitro's supplemental protest identifies two areas where it claims RGE will recover G&A-type costs if recovery of such costs is foreclosed to RGE as a result of the G&A cap. Specifically, Vitro argues that the Navy's cost realism analysis failed to consider RGE's ability to recover general management support costs through direct labor overhead pools, and failed to consider RGE's ability to recover its costs for contract management functions as support labor. In addition, Vitro argues in its supplemental protest that the cost realism analysis cannot withstand scrutiny because the Navy failed to use RGE's Cost Accounting Standards (CAS) Disclosure Statement to analyze the proposal and improperly overlooked RGE's failure to include sick leave costs in its personnel benefits package.

Vitro's arguments correctly identify a dilemma for agencies attempting to perform a cost realism analysis involving single-contract joint ventures--i.e., what is the meaning of capping an entity's indirect costs, including its G&A, when the entity might properly charge every such cost directly? Since the ability of such an entity to charge such costs directly would render the cap meaningless, it is clear that agencies performing a cost realism analysis of a single-contract joint venture's costs must keep a watchful eye on other cost pools within the offeror's accounting system. Failure to do so could result in an unreasonable cost evaluation.

As a general matter, the Navy analysis here shows great care in considering the effect of RGE's status as a joint venture in performing the cost realism analysis. After review of the initial proposals, the Navy candidly noted that RGE's cost proposal was the least reliable of all four offers and presented the greatest likelihood of a cost overrun. However, because of the outstanding technical score awarded RGE and the review panel's recognition that part of the problem was its inability to get past the structure of RGE's proposal, the panel decided to open negotiations and attempt to secure for the Navy the large savings presented by the RGE proposal, if, in fact, its proposed costs were realistic.

After receiving RGE's restructured cost proposal, the Navy performed a second detailed analysis of the RGE proposal before requesting BAFOs. In this analysis, the Navy noted that after reformatting the RGE cost proposal in a style that more closely approximated that used by multiple-contract business entities, RGE and Vitro had proposed substantially similar direct labor at substantially similar costs. The difference between the proposals arose in the

indirect support provided and in the relatively high allocation of G&A by Vitro to its proposal.

Finally, upon receipt of BAFOs, the Navy again evaluated RGE's cost proposal before concluding that the risk of a cost overrun--while still greater than the risk of such an overrun by Vitro--was more than outweighed by the $21 million difference between the proposals.

With respect to Vitro's specific claims regarding recovery of general management support costs as direct labor overhead, and contract management functions as support labor, the Navy acknowledges that RGE allocates such costs as claimed by Vitro, and does not allocate these costs to G&A. Rather than overlooking these costs, however, the Navy's analysis shows they were considered, and shows where, in some areas, they were adjusted upwards based on a comparison with prior Raytheon costs. Despite Vitro's claim that this comparison was unreasonable, we find that the Navy's efforts represented a reasonable effort to ascertain RGE's most likely costs.

We also deny Vitro's claim that the cost realism analysis was unreasonable because the Navy failed to use RGE's CAS Disclosure Statement to analyze the proposal, and improperly overlooked RGE's failure to include sick leave costs in its personnel benefits package. On the first point, there is no per se requirement for an agency to use a CAS Disclosure Statement to perform a cost realism analysis. On the second point, the Navy notes that RGE proposed 3 to 4 weeks of leave for employees to be used as appropriate, and did not include a separate sick leave account. According to the Navy, since other entities provide as little as 2 weeks of annual leave, it concluded that RGE's approach was reasonable. Vitro has provided no reason for us to overturn that conclusion.

Based on our review of the record, we find that the Navy's cost realism analysis here was a candid, well-reasoned, and thoughtful evaluation of RGE's cost proposal. Given our conclusion that the cost realism analysis was reasonable, we also deny the protest to the extent that Vitro challenges the agency's cost/technical tradeoff on the ground that the cost realism analysis of RGE's proposal was flawed.

Finally, we find no basis to support a conclusion that the Navy improperly favored RGE by removing from the solicitation a clause regarding executive compensation.[7]

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[7]A recurring theme throughout Vitro's submissions is that the agency somehow improperly favored RGE throughout the (continued...)

The Navy acknowledges that RGE opposed inclusion of the clause in the RFP, but also explains that internal Navy guidance had suggested that it not be used. Not only is Vitro's complaint untimely,[8] but Vitro offers no evidence as to how it was harmed as a result of removing the clause.

The protest is denied.

James F. Hinchman
General Counsel

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[7](...continued)
procurement, including its decision to hold discussions, and take such steps as necessary to see if it could, in fact, realize the savings offered by the RGE proposal. For the record, we see nothing improper in these actions.

[8]Since the clause was removed from the solicitation by amendment made available to all offerors, Vitro was required to protest the removal of the clause prior to the next closing date for submission of proposals. See 4 C.F.R. § 21.2(a)(1).