



Comptroller General
of the United States

132268

Washington, D.C. 20548

Decision

Matter of: JA & Associates, Inc.; Son's Quality Food Co.
File: B-256280.2; B-256280.4
Date: August 19, 1994

Zane E. Finklestein, Esq., and Alfred C. Koehler for JA & Associates, Inc.; and Keith L. Baker, Esq., Eckert, Seamans, Cherin & Mellott, for Son's Quality Food Co., the protesters.
Riggs L. Wilks, Jr., Esq., and Capt. Gerald P. Kohns, Department of the Army, for the agency.
Christine F. Davis, Esq., and Guy R. Pietrovito, Esq., Office of the General Counsel, GAO, participated in the preparation of the decision.

DIGEST

Agency reasonably canceled a request for proposals for the operation of military dining facilities in the Republic of Korea, where the agency determined that it was more advantageous to fulfill its requirements by novating the existing contract for these services to a successor-in-interest to a bankrupt incumbent contractor and exercising an option under that contract.

DECISION

JA & Associates, Inc. and Son's Quality Food Co. protest the cancellation of request for proposals (RFP) No. DAJB03-94-R-0012, issued by the Department of the Army, for the operation of Army dining facilities in the Republic of Korea. The Army canceled the RFP because it determined to meet its needs through novation of the incumbent contract from the original awardee, Balantine's South Bay Caterers, Inc., to R.S. Data Systems, Inc. and the exercise of the option under the novated contract. The protesters assert that the cancellation is improper and not in the government's best interest.

We deny the protests in part and dismiss them in part.

On April 15, 1993, South Bay was awarded the incumbent fixed-price requirements contract for these services for a base year and 4 option years. Performance of the base year commenced on May 1 and was to conclude on April 30, 1994. On August 23, 1993, 4 months into South Bay's performance of

the base year, the Department of the Navy notified the Army that it had suspended South Bay from contracting with the government because South Bay's president had allegedly, falsely claimed minority status and falsely certified the firm as a small disadvantaged business. Because the suspension would not allow the Army to exercise its options in South Bay's Korea contract, absent a compelling reason, see Federal Acquisition Regulation (FAR) § 9.405-1(b), the Army issued the RFP on November 27 to provide for the continuation of its food service operations in Korea. The RFP provided for the award of a fixed-price requirements contract commencing May 1, 1994, for a base year and 4 option years.

At the time of its suspension from government contracting, South Bay was in reorganization under Chapter 11 of the Bankruptcy Code, pursuant to its voluntary petition for such relief, on July 15, 1993. See 11 U.S.C. § 1101 (1988). The financial impact of the government's suspension of South Bay from contracting, however, caused South Bay's bankruptcy trustee to move for the liquidation of South Bay's assets, pursuant to Chapter 7 of the Bankruptcy Code on November 17; this motion was granted on December 22.¹ See 11 U.S.C. § 701. On December 14, the trustee petitioned the court for an order approving the sale and novation of the Korea contract to R.S. Data, under which R.S. Data would "assume all liabilities, including taxes, severance and employee benefits obligations."² The court approved the proposed novation agreement on January 14, 1994, subject to the Army's approval.

By letter of January 11, the ACO advised the bankruptcy trustee that the Army was concerned that R.S. Data lacked the financial ability and food service experience to perform the contract, and that "it is highly unlikely that the [g]overnment will approve an Agreement to Novate with R.S.

¹In his motion, the trustee represented that South Bay could not reorganize without government contracts and that it could not reasonably secure such contracts in the future, even once its suspension was lifted, because it could no longer certify itself as a small disadvantaged business.

²The trustee communicated the terms of the proposed novation agreement to the administrative contracting officer (ACO) around the time of his court filing, and also raised the possibility that South Bay might repudiate the contract before the end of the base year. To prepare for this contingency, the agency issued a solicitation on December 28 for the award of an interim contract, under which Son's was the low offeror. Offers expired under this solicitation on March 31, 1994, without an award being made.

Data." The government then proceeded with the competition under the RFP, receiving 15 proposals by the January 28 receipt date, including Son's and JA's proposals.

On February 14, the bankruptcy trustee submitted a formal novation proposal on behalf of R.S. Data, as well as a backup novation proposal on behalf of another firm.³ On February 18, the ACO rejected both proposals. Regarding R.S. Data's proposal, the ACO explained that the firm clearly reserved the right to file a claim for additional compensation if it took over the contract under novation, in contravention of FAR § 42.1204(d)(1), which requires the transferee to assume all of the transferor's obligations under the contract.

On March 10, R.S. Data modified its novation proposal to accept the contract in an "as is" condition, in accordance with FAR § 42.1204(d)(1). Nonetheless, on March 14, the ACO again rejected R.S. Data's novation proposal because of its continued concerns about the firm's financial ability and food service experience.⁴ Meanwhile, from March 8 through March 15, the Army evaluated proposals received in response to the RFP.

To allay the Army's concerns about its ability to perform the contract, R.S. Data obtained the financial backing of an investment corporation and negotiated a consulting agreement with a food service contractor. On or about March 17, R.S. Data submitted a revised novation proposal. On March 27, the bankruptcy trustee advised the ACO that South Bay intended to repudiate the contract on April 6, unless the government agreed to the novation or agreed to pay South Bay an additional \$250,000 to complete performance through April 30. In lieu of the \$250,000 payment, the trustee would also accept a \$50,000 payment and the government's agreement to hold the estate "harmless for any accrued but unpaid severance obligations that may arise by virtue of the contract." The referenced obligations due under the contract at the end of the base year constituted a summer bonus payment and a severance payment for all Korean

³The bankruptcy court authorized the trustee to submit alternate novation proposals from other purchasers capable of performing the contract, in the event that the government disapproved the R.S. Data proposal.

⁴The Army indicated that it would be willing to consider the backup novation proposal of the alternate firm, assuming the firm could cure the documentation problems that formed the basis for its earlier rejection. Such documentation was not provided.

employees.⁵ South Bay's contract manager estimated that these payments would amount to \$212,815, and furnished documentation to the government supporting this estimate.

On April 2, the ACO determined that R.S. Data was a responsible contractor, taking into account its proposed affiliate agreements for financial and managerial assistance. The ACO concluded that it was in the government's best interest to novate the contract and to exercise the first option. While Son's proposed price for the upcoming year of performance was \$72,906 lower than the incumbent option price, and Son's proposed price for 4 years was \$211,095 lower than the four contract option prices, the ACO determined that novating the contract and exercising the option was nevertheless most advantageous to the government because R.S. Data had agreed to pay an estimated \$212,815 in Korean employees' severance and summer bonus payments--an obligation which South Bay's trustee had repudiated. A new contractor would not be liable to make these payments, although it would be obliged to maintain the same Korean workers, who might strike if unpaid. Thus, the ACO found that an award to a new contractor entailed the potential for labor unrest, disruption of service, and contracts dispute litigation--all of which could be avoided if R.S. Data assumed performance of the contract. Accordingly, the ACO executed the novation agreement and exercised the first contract option on April 15.

The ACO immediately communicated these actions to the procuring contracting officer (PCO), who was then preparing a business clearance memorandum for the possibility of

⁵These payments were mandated by the regulations applicable to invited contractors working for the United States Forces in Korea. Both the summer bonus payment and the severance payment were equal to 1 month's pay. All Korean employees were entitled to an annual severance payment, despite the fact that the regulations precluded a successor contractor from peremptorily severing these employees.

⁶Prior to novating the contract and exercising the first option, the Army obtained R.S. Data's written assurance that it would assume these severance and summer bonus payments, and memorialized this assurance in an amendment to the contract. The Army has furnished documentation from R.S. Data showing that the severance and summer bonus obligations actually cost the firm \$210,275. Contrary to Son's speculations, there is no evidence in the record that South Bay, rather than R.S. Data, made the required summer bonus and severance payments; in this regard, South Bay had no legal obligation to do so under the terms of R.S. Data's novation proposal.

making an award without discussions to the technically qualified, low-priced offeror. Upon learning that the contract had been novated and the option exercised, the PCO determined that there was no longer a need for a new contract under the RFP. The agency canceled the solicitation on April 15. These protests followed.

The protesters generally contend that the Army unreasonably canceled the solicitation in favor of novating the contract and exercising the first option with R.S. Data. The protesters argue that the prices elicited by the RFP were lower than the incumbent contract option prices, and that this price advantage required an award under the RFP. The protesters dismiss as speculative the agency's concerns regarding South Bay's repudiation or inability to pay the Korean employees' severance and summer bonus obligations, as required by its contract, and the possibility of labor disruption or litigation arising from the failure to make these payments--in the protesters' view, South Bay could be contractually compelled to make the required payments. Thus, the protesters argue that the government could have made award to a new contractor, without fearing the consequences of a default by South Bay.

Contrary to the protesters' allegations, the bankruptcy trustee's March 27 notice of anticipatory repudiation makes clear that the firm did not have sufficient funds to fulfill its year-end employee payment obligations and that South Bay would repudiate the contract on April 6, unless the

⁷The propriety of the novation agreement is a matter of contract administration and therefore not for consideration by our Office. 4 C.F.R. § 21.3(m)(1) (1994); Vantex Serv. Corp., B-251102, Mar. 10, 1993, 93-1 CPD ¶ 221; see T.V. Travel, Inc.; World Travel Advisors, Inc., 65 Comp. Gen. 699 (1986), 86-2 CPD ¶ 27; J & J Maintenance, B-208966, Oct. 6, 1982, 82-2 CPD ¶ 313, recon. denied, B-208966.2, Jan. 17, 1983, 83-1 CPD ¶ 46. Accordingly, we decline to consider the protest issues relating to the propriety of the novation agreement, which was approved by a United States Bankruptcy Court in this case. These protest issues include whether the novation complied with FAR § 42.1204(d)(3), which requires the transferor (South Bay's bankruptcy trustee) to guarantee performance of the contract by the transferee (R.S. Data); whether South Bay's debarment, which was lifted on January 31, 1994, precluded the subsequent novation of its contract to R.S. Data in April 1994; whether the government had the authority to novate the contract when it allegedly suspected South Bay of fraud; and whether R.S. Data was financially responsible or met the definitive responsibility criteria under the solicitation of the contract that has been novated.

government approved the novation or agreed to hold South Bay harmless for the unpaid obligations. Although the protesters argue that South Bay was obligated to perform through the end of the base year and was obligated to pay its employees' severance and bonus payments arising as of that date, the facts of the matter are that South Bay was in the process of liquidation by the bankruptcy court and the bankruptcy trustee had already indicated that South Bay was unwilling or unable to make these payments. The agency could reasonably conclude that any pressure applied by the government would likely have provoked a default, labor unrest, and a disruption of service, and that the only feasible way that the government could avoid these consequences was by arranging for South Bay's successor-in-interest to undertake the performance and associated financial obligations, which the protesters concede would not be the responsibility of a new contractor. In addition, by undertaking these financial obligations, R.S. Data actually offset Son's price advantage for the upcoming year of performance by approximately \$137,000. Thus, we think that the government reasonably determined that procuring these services from R.S. Data, via the novation and the exercise of the first option, rather than making an award under the RFP, was the most advantageous way to satisfy its requirements.

Once the Army decided to fulfill its requirements through the incumbent contract, the Army was really left with no choice but to cancel the RFP. Where, as here, an agency decides to fulfill its requirements through an existing contract and, thus, no longer needs to acquire the supplies or services through the solicitation, cancellation of the solicitation is proper. Thorpe Bldg. Serv., Inc., B-240831, Dec. 17, 1990, 90-2 CPD ¶ 493.

⁸The protesters argue that the Army could have avoided a break in service by awarding Son's an interim contract, once it received notice of South Bay's anticipatory repudiation. However, this would not have resolved the government's concerns regarding the unpaid performance obligations and concomitant labor unrest any more than making an award under the subject RFP.

⁹Son's, for the first time in its final rebuttal comments, suggested that it would have been more advantageous for the Army to novate the incumbent contract to R.S. Data for the purpose of having R.S. Data assume South Bay's debt to its Korean employees and then refuse to exercise the contract option. This protest allegation was not raised within 10 working days of the date on which Son's learned the basis of its allegation and is untimely. 4 C.F.R. § 21.2(a)(2).

JA and Son's argue, however, that the cancellation of the RFP was invalid because the cancellation letter sent to offerors on April 15 was not signed by the PCO. FAR § 15.608(b)(4) provides that all proposals received in response to a solicitation may be rejected if the agency head determines in writing that cancellation is clearly in the government's interest. This authority was delegated to contracting officers pursuant to Defense Federal Acquisition Regulation Supplement (DFARS) § 215.608(b). In this case, the letter canceling the RFP was signed by the agency's Chief of the Contract Operations Division, who is a contracting officer, and, pursuant to DFARS § 215.608(b), has the authority to sign the cancellation letter. In any event, the PCO states that he in fact made the decision to cancel the RFP, although he did not sign the cancellation letter.

JA also challenges the Army's issuance of the solicitation, based upon the allegation that the Army was contemplating the novation of the incumbent contract when the RFP was issued and never intended to make an award under the RFP. This bare allegation is unsupported in the record. At the time the Army issued the solicitation on November 27, 1993, the Army knew that South Bay was subject to a suspension order, which precluded it from performing beyond the base year of its contract, and that South Bay's bankruptcy trustee had petitioned the court for South Bay's liquidation, which left the government susceptible to default by the firm. The government issued the solicitation anticipating that it would need a new contractor to succeed South Bay, without any knowledge that the bankruptcy trustee would subsequently request a novation of the contract on December 14. In this regard, the record reflects the Army's skepticism that it would approve a novation, twice rejecting R.S. Data's novation proposals. The mere fact that the Army ultimately received an acceptable novation proposal from R.S. Data, obviating the need for an award under the RFP, does not establish that the agency acted improperly or in bad faith in issuing the solicitation. See id.; WBM Maintenance, Inc., B-238049, Apr. 20, 1990, 90-1 CPD ¶ 405.

The protests are denied in part and dismissed in part.

/s/ James A. Spangenberg
for Robert P. Murphy
Acting General Counsel