DECISION

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

60288

FILE: B-183705 DATE: December 10, 1975

MATTER OF: Marketing Consultants International Limited

97608

DIGEST:

1. Contract for computer time/timesharing services to prime contractor who has commercial arrangements with potential subcontractors to pay standard percentage of invoice fee for finding buyer of computer time and/or services does not violate Anti-Kickback Act (41 U.S.C. § 51 (1970)) because commercial arrangement does not apply and prime contractor receives fee according to sliding matrix from Government only.

2. Conflict between two contract provisions concerning who pays prime contractor's fee, subcontractor or Government, is resolved in favor of Government payment since that interpretation upholds validity of contract in accord with presumption of legality. Contrary interpretation might lead to conclusion contract violated Anti-Kickback Act.

3. Fact that prime contractor of computer time/timesharing contract may have developed commercial clientele whose abilities it knows does not unduly restrict competition since no potential subcontractor is prohibited from submitting proposal which prime contractor must consider.

4. Contract payment procedure whereby prime contractor's fee is determined as percentage of fixed-price subcontractor proposal does not violate prohibition of 10 U.S.C. § 2306(a) against cost-plus-a-percentage-of-cost contracting.

5. Alternate contract payment procedure, whereby prime contractor's fee is percentage of subcontractor's invoice, and there is no requirement that subcontractor submit fixed-price proposal, violates prohibition of 10 U.S.C. § 2306(a) against cost-plus-a-percentage-of-cost since (1) payment is based on predetermined

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percentage rate; (2) percentage rate is applied to actual performance costs; (3) contractor entitlement is uncertain at time of contracting; and (4) contractor entitlement increases commensurately with increased performance costs.

6. Use of sliding matrix for percentage fee determination that has some points at which fee falls as costs increase does not avoid cost-plus-a-percentage-of-cost prohibition since overall effect of payment procedure is that fee increases and incentive is to raise costs sufficiently to avoid profit depression.

Marketing Consultants International Limited (MCI) protests the award of contract DAHC26-75-D-0008 by the United States Army Computer Systems Support and Evaluation Agency (CSSEA) to RMG Enterprises, Ltd. (RMG), for computer time/timesharing resulting from request for proposals (RFP) DAHC26-75-R-0006. The essential thrust of MCI's protest is two-fold: (1) contract -0008 violates 41 U.S.C. § 51 (1970) (the Anti-Kickback Act), because it permits a subcontractor to pay a fee or commission to a prime contractor for purposes of obtaining a subcontract; and (2) the contracting arrangement is an undue restriction on competition because only firms that agree to pay a fee or commission to the prime contractor will be allowed to compete.

Section E of contract -0008 contains 9 line items for computer time of a specified computer and equipment and required prices therefor on two bases: (a) sub-clin AA, where the contractor, at the initiation of the contracting officer, solicits subcontractor proposals and submits at least two firm fixed-price offers for evaluation and selection by the CSSEA for a fixed fee of $10; and (b) sub-clin AB, where the contractor directly places an order for computer time, causes the task required by the contracting officer to be accomplished and submits an invoice to the CSSEA for payment. CSSEA included the following clauses in contract -0008:

"E.3 The contractor (Time Brokers - South) charges no direct fee for their services under this contract from the customer (The United States of America), but receives compensation in the form of a commission from the seller. Through prior written contracts, sellers of computer

time and timesharing have agreed to charge Time Brokers - South customers the same rate as they would charge any other customer buying their services. The seller of the computer time would then absorb the contractor's commission as part of his marketing overhead. The commission or fee received by the contractor shall be in accordance with, and at the rates shown in the 'payment clause' located in Section J., paragraph 4 of this contract.

* * * * *

"J.4 PAYMENT -

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"b. The contractor receives compensation for his services as part of the sellers standard rates which he charges any other customer buying his service. Because of this unique situation, the contractor most likely will not receive compensation for all orders placed. However, on any orders in which a fee is received by the contractor, the following parameters shall govern payment of, and invoicing by, the contractor.

"1. Since the contractor's standard commission from sellers of computer time is 12 1/2%, regardless of volume, the contractor shall invoice the Government indicating that commission, but receiving compensation from the Government in accordance with the following matrix:

Example of Invoice to Contractor

Sellers invoice for services	- $100.00
12 1/2% commission to contractor	- $ 12.50
Net to seller	---------- $ 87.50

Examples of Invoice to Government

Sellers invoice to Government	- $87.50
Plus Fee 13.5% (see below)	--- $11.90
Government Pays Contractor	--- $99.40

"(Dollar Value - 0 to ($24,999.99 of Invoice	$25,000.00 to $49,999.99	$50,000.00 to $74,999.99	$75,000 and up
(Percentage Fee - 13.5% (Reimbursed	11%	8.5%	6%

"2. Under no circumstances shall the contractor receive compensation for more than the seller's standard charges for services.

"3. The Government shall have access to the contractor's records, notwithstanding all the terms of this contract, to verify that the contractor is adhering to the above guidelines.

"4. Under NO circumstances shall the contractor receive any reimbursement, fees, or commissions from anyone other than the Government. (See ASPR 7-103.20 'covenant against contingent fees 1958 JAN'."

RMG's proposal as submitted contemplated reimbursement on the same terms and conditions upon which it is reimbursed on its commercial transactions. During the course of negotiations, it became apparent to CSSEA that there were significant problems with that arrangement. Consequently, in order to avoid any possible violation of the Anti-Kickback Act, the method of RMG's invoicing procedure and receiving its fee was changed to that in the above clauses. One of the changes was from a straight 12-1/2-percent commission or fee on volume to the above sliding matrix. In this regard, section 10 of amendment 0001 to the RFP specifically indicated that a proposal using a sliding matrix based on the amount of machine time secured per task order was permissible.

Salient portions of RMG's standard commercial agreement indicate that sellers of computer time who enter into such a brokering arrangement with RMG bind themselves to pay RMG a commission of 12-1/2 percent of the amount billed to buyers of computer time located by RMG. The seller further agrees that it will charge only one uniform rate schedule for all buyers of its time

and services, subject to variation for volume, whether or not located by RMG.

The applicable language of the Anti-Kickback Act provides:

> "The payment of any fee, commission, or compensation of any kind or the granting of any gift or gratuity of any kind, either directly or indirectly, by or on behalf of a subcontractor * * * to any officer, partner, employee, or agent of a prime contractor holding a negotiated contract entered into by any department, agency, or establishment of the United States for the furnishing of supplies, materials, equipment or services of any kind whatsoever; or to any such prime contractor * * * either as an inducement for the award of a subcontract or order from the prime contractor or any subcontractor, or as an acknowledgement of a subcontract or order previously awarded is prohibited * * *."

Initially, it appears that sections E.3 and J.4 express conflicting statements as to who pays RMG and the manner in which any fee is determined. This apparent conflict may not be resolved by the Order of Precedence clause of the contract. When construing the various sections of a contract, preference is accorded that interpretation which upholds the validity and harmony of the contract clauses. It is presumed that the contract, as written is legal, and that interpretation which does not ascribe illegality to the contract is preferred. B-163663, May 24, 1968.

Applying the foregoing to the instant case, one must read section J.4 as qualifying E.3. Not only does the text of E.3 itself contemplate resort to section J.4 for determining the method of computing RMG's fee, but the reference to another section in the body of E.3 may be taken as an implication that it was not intended to stand by itself. Further, without considering the impact of J.4, payments contemplated in section E.3 by the subcontractors to RMG standing alone might be construed to be a violation of the Anti-Kickback Act's prohibition against a subcontractor paying a fee to its prime contractor. Thus, in order to uphold the validity of section E.3, the salutory provision of section J.4 must apply. When reading the two provisions together, as intended,

it becomes apparent that section E.3 was a statement of recognition of RMG's commercial dealings that necessitated the specified payment procedure which precluded reimbursement to RMG from anyone other than the Government. Further, while section E.3 is a general statement of policy and recognition of an existing situation, section J.4 provides specific guidelines to be followed, as well as a step-by-step example.

CSSEA cites Howard v. United States, 345 F.2d 126 (1st C.C.A., 1965), to indicate that there are three essential elements that render a subcontracting arrangement violative of the Anti-Kickback Act: (1) the parties are within the class covered by the statute; (2) the contract is a type covered by the statute; and (3) the prohibited payment, as defined in the statute is accepted with knowledge of its nature and purpose, i.e., to induce the award of subcontracts.

We agree with CSSEA that there is no doubt that the first two elements are present here: (a) the parties are the prime contractor and prospective subcontractors of the United States; and (b) the contract was negotiated by the United States for the furnishing of supplies, materials, equipment or services of any kind whatsoever. CSSEA maintains that, under the terms of the contract, the third element is wholly lacking. CSSEA notes that the payment procedure quoted, supra, at section J.4, makes payment of the prime contractor's fee flow only from the Government. Thus, it is asserted that no payment is made by the subcontractor to the prime contractor, either directly or indirectly, for the purpose of inducing an award. CSSEA finds further support for this position in the fact that RMG is bound to secure, and present to CSSEA for its selection, at least two fixed-price offers from time sellers (subcontractors). The option of the Government to select either of the proffered proposals, or reject them both, is seen as a fatal break in any chain of inducement for the prime contractor to award the subcontractor a contract.

At this juncture, it is important to emphasize that the contract calls for two separate tasks for RMG to perform. Under sub-clin AA, RMG, for a stipulated fee of $10, is required to find and present to CSSEA for its selection, at least two firm-fixed price offers from responsible sources. Upon completion of the foregoing, RMG has substantially fulfilled its responsibilities under sub-clin AA. If the Government does not proceed to performance

under sub-clin AB, RMG receives only its fee of $10. If the Government accepts one of the proposals and causes a task order to be issued under sub-clin AB, then RMG receives its fee only according to the sliding matrix. Under sub-clin AB, upon receipt of a task order from the contracting officer, RMG is required to (1) place an order with either a subcontractor of its own selection (e.g. where an urgent requirement necessitates bypassing sub-clin AA), or the subcontractor selected by CSSEA under sub-clin AA; (2) cause the order to be performed; (3) submit an invoice directly to the Government for the total services performed in the manner stipulated in section J of the contract; and (4) receive payment from the Government.

In the case of selection of a subcontractor under the sub-clin AA followed by sub-clin AB situation, we agree with CSSEA that the intervention of the Government in the ultimate selection process acts to wrest from the prime contractor a substantial degree of control in being able to cause awards of subcontracts to particular firms. With this lessening of autonomy, the incentive of a subcontractor to attempt to illegally influence also lessens. In any event, since in this situation the Government, not the prime contractor makes the selection, no violation of the Anti-Kickback Act is evident.

Where an urgent requirement necessitates bypassing sub-clin AA and the Government plays no part in the selection process, the legality of the contracting procedure turns upon another consideration. The absence of a payment by the subcontractor to the prime contractor takes the matter out of the sphere of evil the Anti-Kickback Act was designed to prevent. The evil is the influence on the judgment and corruption of the procurement process, presumptively borne economically by the Government (see United States v. Acme Process Co., 385 U.S. 138 (1966)).

The required payment procedure of section J.4 avoids the problem. The example procedure contained in the section shows that the subcontractor's invoice to the prime contractor reflects the total for the service including the 12-1/2 percent commission. RMG and sellers (subcontractors) of computer time, between whom the commercial arrangement of paying RMG a 12-1/2 percent commission exist, have agreed previously that the sellers would charge RMG

buyers and non-RMG buyers one standard charge. Since the one standard charge was arrived at by absorbing RMG's commission as part of sellers' marketing overhead (see section E.3), the 12-1/2 percent commission is deducted from the amount of the invoice. RMG, in turn, factors in its fee according to the sliding matrix by dollar amount of the invoice (after subtracting the 12-1/2 percent), and submits that amount as its invoice to the Government. Only the Government pays RMG. This discussion applies similarly to the above situation where sub-clin AA is followed by sub-clin AB procedures. In view of this, it is our opinion that the contract does not violate either the letter or the spirit of the Anti-Kickback Act because the potential subcontractors pay no fee, either directly or indirectly, to the prime contractor.

MCI's next basis of protest is that the subcontracting procedure in the contract restricts competition. In summary, it is MCI's view that it is "Pollyanna" thinking to believe that RMG will contract with firms other than those that have agreed to execute the 12-1/2 percent commercial commission arrangement. Thus, if a firm does not care to pay the extra 12-1/2 percent to its existing charge for computer time, or absorb that amount in its existing fee structure, it is effectively restricted from competing to provide the computer time. MCI alleges that RMG has no incentive to search for sellers of computer time beyond those firms with whom it has an existing arrangement, even if the 12-1/2 percent commission is factored out of the seller's invoice price, since it will wish to maintain these select firms as continued clients.

CSSEA advances three reasons why the contract procedure does not restrict competition. The first is that section J.11 of the contract requires RMG to verify that the subcontractor prices are the most cost-effective known and available in the marketplace at the particular time. Second, the payments clause, J.4, encourages competition because of the sliding matrix. Third, the contract incorporates by reference Armed Services Procurement Regulation § 7-104.40 (1974 ed.), entitled "Competition in Subcontracting" which requires subcontractor selection on a "* * * competitive basis to the maximum practical extent consistent with the objectives and requirements of the contract."

While RMG's commercial arrangements govern its conduct for sale of computer time to non-Government sources, RMG's responsibilities are measured by its contractual commitment with the Government. As discussed above, the payment procedures

and other portions of section J.4 have eliminated from consideration the provisions of RMG's standard commercial brokerage arrangement. Since RMG is not dependent upon the seller (subcontractor) for its fee, it is encouraged and contractually bound to effectively canvass the marketplace for the best and most effective prices regardless of commercial affiliation or nonaffiliation. To favor holders of a commercial fee arrangement to the economic detriment of the Government might very well be reason to terminate the contract. Furthermore, not only is there no legal impediment to potential subcontractors' (not in the RMG fold) submitting competitive price proposals for potential consideration but, we believe, the RMG contract would require that firm to consider and evaluate those submissions.

In reaching this conclusion, we are not unmindful of the language of clause J.4(b) where it states:

> "The contractor receives compensation for his services as part of the seller standard rates which he charges any other customer buying his service. Because of this unique situation, the contractor most likely will not receive compensation for all orders placed."

Based on the above, a contract price analyst, before award, was of the opinion that, when subcontracting with firms other than with whom it had commercial agreements, RMG would buy computer time from other sellers and not obtain a fee for that effort. The charge to the Government would encompass computer processing time only.

We are convinced that this opinion is erroneous. Initially, the opinion was based upon the proposal as submitted which, prior to conversion into the contract, envisioned payment in accordance with a commercial practice. Also, although the quoted language above contained the statement that RMG received its compensation from sellers of computer time, this notion was dispelled earlier in our discussion of section E.3 of the contract. The statement that RMG would not receive compensation for orders placed with firms who did not hold RMG's commercial arrangement is premised on the clause that precedes it, "Because of this unique situation." Since this supposed unique situation involving compensation has been explained away, it follows that the conclusion based upon it is also not for application. Finally, the contract price analyst's interpretation would lead to the conclusion that the contract unduly restricts competition by removing all economic incentive from RMG to subcontract with firms that have

not signed RMG's commercial arrangement. We think that any interpretation which envisions the contractor performing a marketplace search and not receiving compensation for that effort is unreasonable. We, therefore, conclude that contract -0008 does not unduly restrict competition.

The applicability of the provisions of 10 U.S.C. § 2306(a) (1970) has been raised by CSSEA.

> "The cost-plus-a-percentage-of-cost system of contracting may not be used. Subject to this limitation and subject to subsections (b)--(f), the head of an agency may, in negotiating contracts under section 2304 of this title, make any kind of contract that he considers will promote the best interests of the United States."

CSSEA maintains that its choice of a brokerage-type contract such as the one here is permissible and has been sanctioned by the Supreme Court in Muschany v. United States, 324 U.S. 49 (1945). Prior to any discussion of the validity of brokerage-type arrangements, as envisioned in Muschany v. United States, supra, the first consideration is whether the contract payment procedure is a prohibited cost-plus-a-percentage-of-cost type. The underlying intent of Congress in prohibiting cost-plus-a-percentage-of-cost contracts was stated by the Supreme Court in Muschany v. United States, supra, at pp. 61-62:

> "The purpose of Congress was to protect the Government against the sort of exploitation so easily accomplished under cost-plus-a-percentage-of-cost contracts under which the Government contracts and is bound to pay costs, undetermined at the time the contract is made and to be incurred in the future, plus a commission based on a percentage of these future costs. The evil of such contracts is that the profit of the other party to the contract increases in proportion to that other party's costs expended in the performance. The danger guarded against by the Congressional prohibition was the incentive to a Government contractor who already

> had a binding contract with the Government for payment of undetermined future costs to pay liberally for reimbursable items because higher costs meant a higher fee to him, his profit being determined by a percentage of cost. * * * Congress * * * indicated it did not care how the contractor computed his fee or profit so long as the fee or profit was finally and conclusively fixed in amount at the time when the Government became bound to pay it by its acceptance of the bid * * *."

We have rendered decisions involving the issue of whether certain types of contractual arrangements constituted prohibited cost-plus-a-percentage-of-costs arrangements. Cf. 35 Comp. Gen. 434 (1956); 38 Comp. Gen. 38 (1958); and 46 Comp. Gen. 612 (1967). The guidelines applicable to this consideration are: (1) payment is on a predetermined percentage rate; (2) the predetermined percentage rate is applied to actual performance costs; (3) contractor's entitlement is uncertain at the time of contracting; and (4) contractor's entitlement increases commensurately with increased performance costs.

Counsel for RMG and CSSEA argue for the validity of the payment procedure on the basis that reimbursement is not on the basis of costs. Both note that section L of the contract incorporates by reference only ASPR clauses applicable to fixed-price service contracts. Further support is cited at sections E.1, E.2, H.2, J.4, J.9, J.10, and J.11 of the contract.

We agree with both counsels, but only to the extent that the sub-clin AA followed by sub-clin AB situation is involved. As regards this situation, subcontractor proposals are submitted on a fixed-price basis. RMG's commission is computed as a percentage of that fixed price. Therefore, sub-clin AA does not involve a cost-type contract subject to the prohibition of 10 U.S.C. § 2306(a) (1970) since the amount of the contract is known to the Government at the time it selects a proposal. In our view, both RMG and CSSEA incorrectly apply the fixed-price requirements of sub-clin AA to direct sub-clin AB orders.

Direct sub-clin AB orders, on the other hand, permit RMG to select a subcontractor and proceed with the work before an invoice is submitted. In this procedure, there is no requirement that RMG receive a fixed-price proposal. CSSEA does not review any proposals prior to receiving RMG's invoice. The invoice

submitted to the Government shows only the subcontractor's total price (minus the aforementioned 12-1/2 percent fee), RMG's sliding matrix fee, and a total. In this light, we conclude that RMG's sliding matrix fee has been calculated as a percentage of the subcontractor's invoice which, of course, includes its costs.

In our opinion, the presence of the first element listed above constituting a cost-plus-a-percentage-of-cost contract for direct sub-clin AB situations is clearly present.

The second element is present in that the predetermined percentage rate is applied to actual performance cost. The invoicing procedure of subsection J.4(b) shows that the sliding matrix fee rate is applied to the subcontractor's invoice including the performance costs presented to the prime contractor prior to submission to the Government.

The third element is that the contractor's entitlement is uncertain at the time of contracting. CSSEA argues the applicability of Muschany v. United States, supra, on this element. In that case, the Government agreed to pay a broker a 5-percent commission of the purchase price for certain lands upon which the broker obtained options for the Government. The Supreme Court found this arrangement outside the scope of a similar cost-plus-a-percentage-of-cost prohibition primarily because the Government had to approve the option price before the contract was consummated. Thus, the contractor's entitlement was ascertainable and certain at the time of contracting. This is the sub-clin AA followed by sub-clin AB situation. However, without the required Government review found in that situation before RMG places an order with a subcontractor in a direct sub-clin AB situation, the Government does not know the amount of the order until it receives the invoice from RMG. Thus, the third element is present.

As to the application of the fourth element, it is conceivable that RMG may receive a smaller fee as the subcontractor's costs rise. This may occur for tasks that just cross the percentage

demarcation lines. For example, if the subcontractor invoice is $24,900, RMG's fee under the sliding matrix would be 13.5 percent of that amount, or $3,361.50. If the subcontractor costs just cross the $25,000 percentage cut-off to which an 11-percent fee applies, RMG would receive $2,750. A similar fee reduction appears at each breaking point in the sliding matrix at $25,000 intervals.

We recognize the foregoing, but do not consider that it cures an otherwise prohibited method of computing payments. The overall thrust of the payment method is that RMG receives a larger fee the greater the subcontractor invoice. The incentive, therefore, is for greater subcontractor costs. While it is true that RMG's fee may decrease as the subcontractor costs cross the $25,000 increments, the incentive, in that situation, is to have the subcontractor costs increased sufficiently to avoid that profit depression. We therefore conclude that the method of payment for orders issued directly pursuant to sub-clin AB is prohibited by 10 U.S.C. § 2306(a) and the contract to the extent that it permits the method of payment is void.

Accordingly, any outstanding obligations which arose pursuant to a direct sub-clin AB order may be paid on a quantum meruit basis. See 38 Comp. Gen., supra. If upon review, CSSEA determines that its needs cannot be fulfilled without resort to direct sub-clin AB tasks, and that portion of the contract is not severable from sub-clin AA followed by sub-clin AB tasks, the latter portion should be terminated for the convenience of the Government and the requirement resolicited.

The foregoing renders it unnecessary to discuss the general validity of this type of brokerage contract.

In view of the above, this decision is being transmitted by letters of today to the congressional committees named in section 232 of the Legislative Reorganization Act of 1970, Public Law 91-510.

R. F. Keller

Deputy Comptroller General
of the United States