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DECISION

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

FILE: B-190036 DATE: May 11, 1978

MATTER OF: E.D.S Federal Corporation

DIGEST:

1. When Federal Government makes grants, it has right to impose conditions on grants. Had HEW not monitored grantee award for compliance with Federally-imposed conditions, HEW would have had no guarantee that policy purposes of requirements would be met.

2. HEW's decisions on review of grantee's procurement did not establish additional procurement standard or violate provision authorizing grantee to use own procurement policies subject to Federal conditions.

3. Since grantee procurement was negotiated, provision permitting grantee to reject all bids when best interests dictated did not strictly apply. In any event, provision did not require grantee to cancel procurement but only permitted rejection.

4. There is nothing in record to indicate that HEW's procurement guidance to grantee was other than reasoned attempt to prevent restriction on competition which HEW felt would have ensued had grantee canceled procurement and resolicited requirement using stringent certification requirement.

5. It was not improper for grantee to permit competitor opportunity to propose less stringent requirement than that which grantee had initially proposed, since negotiated procedure permits even

negotiation of alleged "nonresponsive" offer. Complainant was not prejudiced by lack of opportunity to respond to certification requirement since requirement had no pricing effect. It is irrelevant to speculate what outcome of competition would have been had requirement been priced.

6. It is not necessary to consider whether claim for proposal preparation costs in grantee procurement may be considered when claim cannot be allowed because procurement procedures were proper.

E.D.S. Federal Corporation (EDS) has requested our review of a contract awarded to The Computer Company (TCC) by the State of North Carolina, a grantee of the Department of Health, Education, and Welfare (HEW). Basically, EDS takes issue with guidance furnished by HEW during the pendency of the procurement leading to the TCC award. For the reasons set forth we cannot question the guidance.

The contract, according to HEW, is to "assist the State to perform its role as the single State agency responsible for administering the pharamaceutical services component of the Medicaid program as authorized under P.L. 89-97."

The HEW guidance contested by EDS had to do with the "Medicaid Management Information System (MMIS) certification"--an HEW certificate allowing a State to receive additional Federal funding in recognition of the State's (or its Medicaid claims contractor's) compliance with a "prescribed general system design" for Medicaid claims processing.

The proposal documents for the procurement as initially issued by the State did not require MMIS certification for the pharamaceutical services contract in question. Only proposals from TCC and EDS were received.

Thereafter, competitive negotiations were held with TCC and EDS. As a result of negotiations, TCC--the offeror submitting the most financially advantageous proposal--was selected by the State for the period September 1, 1977, to June 30, 1978. This selection, HEW reports, did not meet with the initial approval of the North Carolina Advisory Budget Commission whose stated function, in part, is to approve decisions which would commit the State to a contractual arrangement. HEW further reports:

> "* * * As the enclosed documentation indicates, the ABC seems to have favored cancelling the existing RFP after TCC ha[d] been selected on a free and open competitive basis. * * * The apparent reason for the proposed cancellation was that the RFP did not require MMIS certification which could have entitled the State to an additional 25% in Federal matching funds. The ABC was operating under the assumption that it could cancel the RFP and resolicit proposals requiring MMIS certification. Further, the ABC wanted the RFP to require that the MMIS be installed and certified within 90 days."

By letter dated July 8, 1977, to HEW, the State requested concurrence in its proposed approach of cancelling the RFP and resoliciting proposals. HEW reports that the letter was submitted to its Regional Medicaid Director under "42 C.F.R. § 449.82(d)(i) [which] provides that 'All expenditures which can reasonably be expected to exceed $100,000 in total during the contract must be approved in writing by the Regional [HEW] Medicaid Director prior to the execution of the contract.'"

By letter of July 11, 1977, the Regional Medicaid Director advised the State that the proposed cancellation of the RFP would be "inappropriate where a substitute procedure is available" and denied the request.

The "substitute procedure" proposed by HEW was an amendment of the "existing proposals to reflect the competing firms' acceptance of the provision for a penalty in the event of non-[MMIS]-certification." The Director further informed the State:

> "It is also our position that a very short MMIS required certification schedule would unnecessarily restrict competition which would directly conflict with 45 CFR Part 74, Subpart P, Section 74.153. Compliance with 74.153 is considered mandatory by the provisions of 45 CFR 249.32 paragraph(d)(1) if expenditures for a fiscal agent contract are to be approved for FFP. In order to preclude a restriction on competition we request that the MMIS certification schedule stipulate certification in not less than 180 days from the date of the beginning of processing claims under the contract for which the MMIS is required.
>
> "Any approval of expenditures under a contract resulting from your R.F.P. will be contingent upon compliance with the above comments."

By letter of July 16, HEW also informed the State that:

> "The existing responsive bid proposals shall not be rejected but will be utilized as submitted, subject only to the changes necessary to comply with the requirements set forth below:
>
> "a. The State requiring a guarantee of MMIS certification.
>
> "b. The MMIS certification schedule shall be not less than 180 days from the beginning of processing claims under the contract for which an MMIS is required.
>
> "c. None of the above changes may be utilized to disqualify the low bid proposal [submitted by TCC]."

Acting in accordance with the HEW guidance, the State, by letters dated July 20, 1977, requested EDS and TCC to agree to an "MMIS certification amendment." The letters also informed the companies that "no changes to the cost proposal[s] [would] be considered." Briefly, the amendment provided:

(1) The contractor was to obtain MMIS certification not later than 180 days from the date of the beginning of claims processing under the contract;

(2) In the event certification was not obtained within the 180 days period, the contractor would be liable for damages unless the failure to obtain certification was found by the State not to be the contractor's fault;

(3) Failure to obtain certification might result in forfeiture of the performance bond.

By letter dated July 27, EDS accepted the contract amendment "without qualification" at no charge to the State. By letter of the same date, TCC expressed "several reservations" about the amendment especially since the "State Agency [was] requiring of the contractor considerable work in addition to that described in the original RFP." Consequently, TCC could not quote an "accurate cost estimate" for the MMIS work and suggested that the proposed "start-up allowance" should be expanded. Further, TCC informed the State that it would have to furnish a "letter of credit" guaranteeing MMIS certification rather than the stipulated performance bond. Finally, TCC stated it was limiting its "responsibility for loss" under the amendment.

After reviewing the responses of EDS and TCC, the State made an award to TCC--the low offeror on a price perclaim standard--based on the existing RFP provided that TCC furnished an irrevocable line of credit of $250,000 for "federal certification of the Medicaid Drug Program."

Upon learning of the TCC award, EDS filed a complaint with our Office and filed suit in a North Carolina State Court. EDS's suit was then removed

to Federal District Court where the suit was recently dismissed without prejudice. Since the suit was dismissed without prejudice, we will review the complaint. See Optimum Systems, Inc., 56 Comp. Gen. 934 (1977), 77-2 CPD 165.

EDS's complaint may be summarized under the paragraphs numbered below.

(1) There was no basis in law or fact for "HEW to deviate from the mandate set forth in 45 C.F.R. § 74.150 and 45 C.F.R. § 74.151 that the [procurement] standards utilized by the grantee and its procedures for rejections of bids should be left to the grantee." HEW regulations further provide that it will not "impose additional procurement standards or the grantee" contrary to HEW's actions under this procurement."

(2) Federal procurement law (embodied in 45 C.F.R. § 74.154) specifically authorized a grantee to reject all bids received under formal advertising when the grantee's interests, as here, so dictated. Contrary to HEW's views, the procurement was more akin to the Federal 2-step advertised procedure rather than a negotiated procurement. HEW's action contravenes those GAO decisions (see, for example, Blount Brothers Corporation; et al., B-185322, March 11, 1976, 76-1 CPD 172) which have upheld grantee decisions to cancel solicitations even when the rejection was arbitrary.

(3) The State's Attorney General's office has taken the position that HEW's actions were improper under State law and Federal regulation.

(4) HEW also improperly dictated the terms of the MMIS provision and the requirement that TTC's low proposal could not be excluded because of the provision thereby, in effect, causing the State to feel compelled to award to TCC.

(5) In response to the State's initial request for offerors to comply with a "180 day MMIS" requirement, EDS accepted the provision without restriction; on

the other hand TTC "phrased [its] version of the [MMIS] amendment to limit [its] responsibility for loss." By allowing TCC the opportunity to accept an MMIS amendment with "limit[ed] responsibility for loss," the State "violated standards of basic fairness"; furthermore, TCC's failure to agree completely with the State's initial MMIS amendment should have required either the rejection of TCC's final offer as nonresponsive or a State decision to allow EDS the opportunity to offer the lesser MMIS coverage proposed by TCC.

(6) HEW prejudiced EDS's competitive position by directing that the cost associated with the MMIS amendment could not be considered in deciding the successful offeror--if the cost of the amendment had been reflected in the competition EDS would have been selected.

(7) Because of HEW's arbitrary actions, the Department should reinburse EDS for its proposal preparation costs.

HEW has replied to the above-numbered paragraphs as follows:

(1) HEW had the obligation to approve, in advance, the expenditures involved here under authority of 42 C.F.R. § 449.82(d)(2)(i) which provides that "All expenditures which can reasonably be expected to exceed $100,000 [as here] * * * must be approved in writing by the Regional Medicaid Director prior to the execution of the contract." Moreover, additional HEW regulations required HEW to insure that the procurement was conducted in a manner so as to provide "maximum open and free competition" (45 C.F.R. § 74.153, Free Competition) and that the specifications to be used by the grantee did not "unduly restrict competition" (45 C.F.R.§ 74.154, Procedural Requirements). Both these regulations require HEW to monitor the grantee's procurement for compliance with the stated goals. Because of the high dollar value of this and related procurements, HEW is generally aware of the grantee's procurement practices; therefore,

HEW must take exception to improper procurement practices as discovered rather than waiting to take exception to improper grantee practice at the time of final payment. Moreover, HEW felt it would have been contrary to free and open competition to have permitted the State to cancel and resolicit new proposals when the reason advanced for cancelling was the incorporation of an MMIS requirement limiting competition to one concern, EDS.

(2) The right of the State to reject all bids is subject to the requirement that the reason for rejection not contravene Federally-imposed requirements. The cited GAO decision involved an advertised procurement unlike the negotiated procurement made by the State; thus the cited provision does not apply in any event.

(3) Regardless of the State's position, HEW insists that its federal review role was proper.

(4) HEW suggested an MMIS provision which would preserve competition between the concerns and not afford EDS an unfair advantage.

(5) Federal procurement law does not apply to the subject procurement; hence, it was proper for the State to conclude an award with TCC as it did.

(6) It would have been improper to have allowed an MMIS amendment to affect offered costs, since this would have given EDS an unfair advantage.

(7) Claim for bid preparation is not supported by the facts. (The HEW positions advanced under arguments 3, 6 and 7 are implicit in the HEW report.)

ANALYSIS

When the Federal Government makes grants, it has the right to impose conditions on those grants. King v. Smith, 392 U.S. 309 (1968). As stated by the Supreme Court at page 333 n. 34 in the cited case:

> "There is of course no question that the Federal Government, unless barred by some controlling constitutional prohibition, may impose the terms and conditions upon which its money allotments to the States shall be disbursed, and that any state law or regulation inconsistent with such federal terms and conditions is to that extent invalid. See Ivanhoe Irrigation District v. McCracken, 357 U.S. 275, 295 (1958); Oklahoma v. Civil Service Comm'n, 330 U.S. 127, 143 (1947). * * *"

HEW specifically conditioned expenditure of Federal monies for the contract involved in three ways: (1) By reserving the right to approve contracts awarded by grantees in excess of $100,000; (2) By requiring grantees to obtain "maximum open and free competition"; and (3) By requiring grantees to avoid specifications that "unduly restricted competition." Clearly, these requirements authorized HEW to review the proposed award to determine the States' compliance with these conditions. Indeed, had HEW not monitored the award for compliance with the requirements, the agency would have had no guarantee that the policy purposes of the requirements would be fulfilled. See Griffin Construction Company, B-185474, November 29, 1976, 76-2 CPD 452.

Having rejected the position implicit in EDS' complaint that HEW's review role was objectionable in itself, we now address the company's grounds of protest (keyed to the above-numbered paragraphs).

(1) We find nothing inconsistent in HEW's position that its review decisions in grantee's procurement did not constitute a prohibited "additional procurement standard" or violate the requirement that grantees "may use their own procurement policies" subject to HEW-imposed conditions.

(2) Offerors were allowed the right to modify both original technical and cost proposals in the subject procurement. In Federal 2-step procedures, second-step price proposals are not changed. In our view, the procurement was negotiated; thus the right of the grantee to reject bids in its best interest under Federal regulation did not literally apply here. In any event, the regulation only permits a grantee to cancel an advertised procurement and does not mandate a rejection. Although, as a practical matter, the State may not have had the choice to avoid the HEW directive mandating the continued existence of the RFP, the fact remains that the State, as a legally free agent, decided not to exercise its presumed right to cancel in order to preserve Federal funding. The circumstance is therefore distinguishable from Blount Brothers Corporation, supra, when the complaint challenged the grantee's decision to cancel an advertised procurement.

(3) The memo of the representative of the State's Attorney General's office questioning the HEW actions apparently is not the official position of the State. In any event, we must reject the position of the memo for the reasoning set forth in this decision.

(4) There is nothing in the record to indicate that HEW's stipulations concerning the certification were other than reasonable. Indeed, EDS does not deny HEW's assertion that a more stringent certification period would have left only EDS eligible for award other than expressing the opinion that the State apparently did not believe competition would have been so restricted. The fact that only two offerors out of the dozens of concerns solicited actually competed for the award and that only EDS initially offered a retroactive certification period (thereby entitling the State to additional Federal funds) confirms our view that HEW did not act arbitrarily in directing the terms of a minimum certification period so as to preserve competition.

(5) The concept of "bid responsiveness" is generally not for application in negotiated procurements where it is recognized that even "nonresponsiveness" may be a subject of negotiation. See ERA Industries, Inc., B-187406, May 3, 1977, 77-1 CPD 300. Consequently, it was not improper for the State to permit TCC the opportunity to propose a less stringent requirement than that which the State initially proposed. To the extent the State relaxed a bonding requirement otherwise for application in State-funded procurements, the State's decision can be seen as compliance with an overriding Federal purpose--the preservation of competition; thereby under King v. Smith, supra, the State properly acquiesed in the Federal decision. Moreover, since the certification requirement had no pricing effect, EDS was not prejudiced by the lack of opportunity to respond to the final certification requirement incorporated in the TCC contract.

(6) HEW properly decided that the requirement was not to affect prices so as to preserve competition. Therefore, it is irrelevant as to what the outcome of the competition would have been had the requirement been allowed to have a pricing effect.

(7) EDS' claim for proposal preparation costs cannot be allowed where proper procedures were followed as here. Consequently, the question whether a bidder on a grantee procurement can recover bid or proposal preparation costs will not be decided. Planning Research Corporation Public Management Services, Inc., 55 Comp Gen., 76-1 CPD 202.

Complaint denied.

Deputy Comptroller General
of the United States