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R. Mc... Proc II

DECISION

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

FILE: B-190142 DATE: February 22, 1978

MATTER OF: General Telephone Company of California

DIGEST:

1. Provision for considering residual value of purchased equipment in comparing the relative cost of leasing as opposed to purchasing equipment is reasonable. Moreover, protester has not shown that method for computing amount of residual value of purchased equipment based on equipment's anticipated useful life to Government is erroneous.

2. Lease proposals should be evaluated over longest time equipment will be leased under contract and option periods contemplated by solicitation. Whatever rights Government might have to telecommunications equipment upon expiration of ten year lease are too nebulous and speculative to be used as evaluation factor.

3. Possibility that additional taxes would accrue to Government through lease rather than purchase of equipment is too speculative to be considered in evaluating relative merits of such proposals.

4. Costs of Government self-insurance of purchased equipment are too indefinite, speculative and undeterminable to be used as evaluation factor in comparing offers of leases and purchases.

5. Although Government may in appropriate circumstances self-insure leased equipment, record in this case does not support conclusion that agency acted unreasonably in requiring lessors to assume risk of loss.

B-190142

The General Telephone Company of California (GTC) protests evaluation factors in Request for Proposals (RFP) No. 9PN-126-A77/LC(NEG) issued by the Procurement Division, Federal Supply Service, General Services Administration (GSA), San Francisco, California. Essentially, GTC seeks more favorable evaluation of its lease-based proposal in comparison with proposals for the Government's purchase of equipment.

The procurement concerns the acquisition of telephone equipment, maintenance and related services and contemplate lease, lease with option to purchase or purchase. The RFP states that award will be made to the responsive and responsible offeror with the lowest present value price over a 10 year period. The solicitation cautions, however, that a lease plan may be selected over a less costly purchase plan if adequate purchase funds are not available. The solicitation contains a provision for evaluating the "residual value" of purchased equipment in comparing the cost of purchasing to the cost of leasing equipment. Essentially, the Government proposes to evaluate the anticipated value of purchased equipment remaining at the completion of ten years. It states as follows:

> "Residual values are computed after allowance for depreciation at an annual rate of 5.4 percent. This rate is assumed to be the same for all items of equipment. Only when the Government may acquire title to a system under a proposed plan will the residual value be an evaluation factor. Residual values will not be applicable under a lease only option."

The protester states that this provision establishes a 46 percent residual value for purchased equipment at the end of 10 years and that the annual depreciation rate was calculated by GSA on the basis of a useful life of 18.5 years. GTC argues that this is arbitrary, excessive and based on erroneously interpreted data from an obsolete survey by the Federal Communications Commission

(FCC). It states that recent technological improvements and mandates of the FCC have led to increasingly rapid obsolescence so it cannot be reasonably anticipated that this equipment will have a useful life approaching 18.5 years. It has submitted a Bell System survey, dated February 2, 1977, indicating for similar equipment a service life of 12.8 years and an annual depreciation rate of 7.6 percent. GTC points out that recent developments have led many experts to believe the future useful life of such equipment will decrease, approximately, to 7 years. It further contends that the 46 percent residual value is inherently unfair to a lease-only offeror whose offer will be evaluated on a 10 year basis and who must recover capital investments within the first 5 years because it is guaranteed only a 5-year lease with an option to renew for another 5 years.

The protester alternatively argues that if GSA is permitted to recognize for evaluation purposes a residual value of 46 percent of purchase price for purchased equipment at the end of 10 years, it should be required to recognize a similar residual value to the Government in leased equipment at the end of 10 years. The protester argues that when a vendor or lessor recovers its capital expenditures, a seller can raise its prices for maintenance or even refuse to continue the maintenance whereas the lessor is regulated and must continue maintenance at approved rates based on service costs only. The protester states that GSA's right to have purchased equipment moved and reinstalled is worthless since the cost of doing so invariably will exceed the value of the equipment. Thus, the protester contends the equipment, whether bought or leased, should be similarly evaluated with regard to residual value and that assigning a residual value only to purchased equipment constitutes an undue restriction on competition in violation of applicable laws and regulations.

GSA defends the 46 percent residual value factor for purchased equipment by stating that the selection of evaluation factors is a matter of judgment concerning which opinion as to reasonableness may differ; that different criteria may be appropriate for different applications; and that the selection of the 5.4 depreciation rate from which the 46 percent residual value results was based on, among other things, a 1974 study by the FCC. GSA contends that within the Continental United States its own experience indicates a useful life of 16.11 years for Government-owned PBX equipment and 26.4 years for equipment outside of the United States. It states that the useful life of PBX systems in new Government buildings has run as high as 30 years. It notes that a purchased system can be moved for the cost of removal and reinstallation and a leased system has to be returned to the owner and a new system procured for the new location. GSA contends that because the Government is required to procure only for its essential needs, it is less likely to change for the sake of obtaining more modern and usually more expensive systems. It concedes communications technology has made rapid advances in recent years but states that while such advances may have reduced the "state-of-the-art" life of communications systems, they also substantially have increased the physical life or durability of these systems and the ease with which they can be updated. GSA denies that the 5.4 percent depreciation rate is unfair to lease-only offerors or that it has prevented them from competing effectively. The agency argues that the absence of a residual value factor would be unfair to sellers. Because 40 U.S.C. § 481(a) provides that contracts for public utility services may not exceed 10 years, GSA states that it cannot evaluate offers for lease only on the basis of a useful life of 18.5 years whereas the useful life of purchased equipment may be evaluated.

The Administrator of GSA is specifically authorized under 40 U.S.C. § 295 to provide and operate public utility communications services for governmental activities where it is found that such services are economic and in the interest of the Government. Under 40 U.S.C.§ 481, the Administrator is directed to procure for executive agencies personal property and nonpersonal services, "Provided, that contracts for public utility services may be made for periods not exceeding ten years." Under 40 U.S.C.§ 474, the authority of the

Administrator is not "subject to the provisions of any law inconsistent herewith." The equipment being acquired in this procurement is being funded through the Federal Telecommunications Fund established by 40 U.S.C.§ 757, which is available to GSA without fiscal year limitation for procurement by lease or purchase of equipment necessary for operation of the federal tele· communications system.

The determination of its minimum needs and the methods of accommodating them are properly the responsibility of the contracting agency. Maremont Corporation, 55 Comp. Gen. 1362, (1976), 76-2 CPD 181; 48 Comp. Gen. 62, 65 (1965). This Office will not substitute its judgment for that of the contracting agency unless it is shown by convincing evidence that the agency's judgment is unreasonable and that a contract awarded on the basis of its specifications, which unduly restricts competition, would be in violation of law. Keystone Diesel Engine Company, Inc., B-187338, February 23, 1977, 77-1 CPD 128; METIS Corporation, 54 Comp. Gen. 612 (1975), 75-1 CPD 44. Though the specifications must be drawn to maximize competition, the fact that one or more potential offerors may be precluded from competing because of those specifications does not render specifications unduly restrictive if they reflect the legitimate needs of the agency. 45 Comp. Gen. 365 (1965); Informatics Inc.-Reconsideration, 56 Comp. Gen. 663 (1977), 77-1 CPD 383. The prohibition against undue restriction of competition does not require compromise of a procurement method which is beneficial to the Government in order to accommodate the selling or leasing policies of all potential offerors.

In essence, 40 U.S.C.§ 481 establishes for evaluation purposes here a maximum 10 years for leased equipment. There, obviously, is no similar consideration with regard to purchased equipment because the Government, in purchasing equipment, acquires title within the statutory period. Moreover, in Linolex Systems, Inc., et al., 53 Comp. Gen. 895 (1974), 74-1 CPD 296, this Office stated that the only proper time frame for evaluation of lease proposals was the longest time the system would be leased under the terms of the contract contemplated by the RFP and that to do otherwise would result in the Government not obtaining a true and realistic picture of proposals and their costs.

In the case at hand, GSA has determined that purchased equipment has an actual useful life in excess of 10 years but must be evaluated on a 10 year basis only to facilitate the comparison of the total costs over the maximum lease period. At the end of 10 years, GSA will have no enforceable rights to leased equipment but with regard to purchased equipment, it will have complete control and title and the reasonable value of such title and control should not be ignored in the cost comparison. In General Telephone Company of California, 57 Comp. Gen. 89 (1977), 77-2 CPD 376, we recognized the residual value of purchased equipment as a proper evaluation factor provided the solicitation gives proper notification thereof.

The protester's suggestion that residual value be evaluated in the event of both the purchase and lease of equipment overlooks several factors. While cost considerations of moving and reinstalling equipment would reduce the value of purchased equipment, the equipment may remain in place for many years beyond the 10 year evaluation period. A regulated lessor may be obligated to continue maintenance after 10 years at rates based on service costs only as approved by a regulatory commission but this obligation is not controlled by GSA and would not exist with regard to lessors whose maintenance rates are not regulated. It is uncertain at this time what those rates will be. Further, regulated lessors do not permit maintenance of their equipment by Government personnel or by other contract personnel. Thus, GSA would be restricted in its maintenance options for leased equipment.

While the protester has submitted arguments and data indicating that organizations may be using different depreciation rates for similar equipment and that the trend for some users in industry is toward higher rates and a shorter useful life, it has not shown that the needs, interests, limitations and purposes of such users are sufficiently similar to those of the Government to conclude that the 5.4 percent depreciation rate is clearly unreasonable for use in this procurement. The record indicates that the residual value and the depreciation rate was established by GSA after consideration of pertinent information available to it at the time. We cannot conclude from the record that the residual value and depreciation rate have been shown to be without a reasonable basis.

GTC contends GSA's evaluations must consider taxes the Government will lose if it buys rather than leases the equipment. It recognizes that a tax will be paid on the revenues generated whether the equipment is sold directly to the Government or to a lessor which will lease it to the Government and that the revenues generated by maintenance charges will also be taxed whether the equipment is bought or leased. In the case of purchased equipment, it contends that no further taxes will be received whereas additional taxes will be imposed for each year equipment is leased. GTC asserts that such lost Federal taxes are not speculative and can be determined as shown by Office of Management and Budget (OMB) Circular No. A-76 which requires consideration of such costs when an agency decides whether to provide goods or services "in-house" or to procure them from other sources.

We think the two situations are clearly distinguishable. If, as considered in Circular A-76, the Govvernment satifies its requirements with its own employees there would be no taxable profit. Here, however, the protester seeks to have the Government evaluate and compare the taxes generated as between the sale and lease of the equipment. The protester recognizes that in either case, purchase or lease, the contractor would be subject to tax. However, corporate income taxes are based on profits and we believe the suggested comparison would be mere conjecture. Moreover, in 43 Comp. Gen. 60 (1963), we stated:

"* * * There are many existing unequal competitive situations of which the procurement laws take no notice. For example, procurement procedures do not attempt to equalize the natural competitive advantage enjoyed by a concern with respect to lower transportation costs resulting from close proximity of a plant to the required delivery point of the goods being purchased by the Government. Nor do these procedures attempt to equalize possible financial disadvantages with respect to income tax rates and tax treatment under which private individuals doing business with the Government must operate as opposed to the rates and treatment under which corporations operate. Such examples may be multiplied. If these factors, and factors of like nature, were to be given weight in the bid evaluation process so as to equalize the competitive position of bidders, that process would be fraught with speculation, confusion and suspicion. We believe that if indirect benefits to the Government, which in most cases are incapable of advance and accurate measurement, are to be introduced into the evaluation process that result should be accomplished by legislation."

OMB Circular A-76 provides no support for the practicability of using potential lost taxes as a basis for a bid evaluation factor. It merely expresses Executive Branch policy and is applicable neither to comparison of procurement by lease versus purchase nor to the establishment of evaluation factors for purposes of contract award. General Telephone Company of California, supra; 53 Comp. Gen. 86 (1973).

GTC contends the solicitation is also defective because of failure to include as an evaluation factor the cost to the Government of its self-insurance of purchased equipment, while requiring offerors who propose leases to assume the risk of loss. GTC suggests that the only equitable way to evaluate the disparate insurance obligations of vendors and lessors is to add to the vendor's price a figure equivalent to the self-insurance costs to the Government of its own property, or for the Government to assume the risk of loss of leased equipment. It points out that Department of Defense (DOD) Directive 4100.33, July 16, 1971, which implements OMB Circular A-76, uses an evaluation cost factor for self-insurance of $3.00 per $1,000 property valuation. In response, GSA contends that the Government's policy of self-insurance involves an assumption of risk and that an attempt to calculate its cost would require highly speculative theorizing as to the equipment's potential for loss.

The Government has a long established policy of self-insuring its own property. It is noted, however, that Government self-insurance is not "insurance" in the normal sense of spreading the risk among many contributors. Rather, it is an assumption of liability to be liquidated from appropriated funds at the time of loss without the prior establishment of loss reserves or other normal incidents of commercial insurance. This policy is based on the theory that the magnitude of the Government's resources, with many exposure units with wide geographic dispersion, makes it more advantageous for the Government to assume its own risks than to insure them through private insurers at rates sufficient to pay all losses and operating expenses with profit for the insurers. While this policy doubtless involves costs to the Government resulting from inevitable losses of its property, we are aware of no central source having general or specific data on the annual cost of such losses with their attendant administrative expenses, from which costs of risk assumption could be calculated for all of the various types of property. As long as the costs are indefinite and speculative, we do not recommend their use as an evaluation factor. 53 Comp. Gen 676 (1974); 43 id. 60 (1963). As stated above, OMB Circular No. A-76 is not intended to apply to the establishment of evaluation factors as between offerors contending for contract award.

In our opinion, the record does not support a conclusion that the RFP provision requiring lease-only offerors to assume the risk of loss of leased equipment used solely in the performance of the contract in a Government facility is without a reasonable basis. While it may be that the risk of loss for such equipment may be assumed by the Government where the lessor's insurance costs constitute a severable and significant portion of the lease rates, the potential liability is within available appropriations and other considerations indicate that it would be to the best interest of the Government, we know of no legal requirement for such an action in this case. See Proposed Assumption of Property Risk on Real and Personal Property Owned by Certain Contractors, B-168106, July 3, 1974, 74-2 CPD 3; Reconsideration, 54 Comp. Gen. 824 (1975). If a lease-based offeror is in a position to reduce significantly its price if the Government assumes the risk of loss, it is possible for such offeror to propose alternative proposals to persuade the Government to relax its requirements.

GTC further contends that as leased equipment will be removed at no cost to the Government at the expiration of the lease and any extensions, GSA should add to the prices from vendors the cost of removal by the Government when the purchased equipment is no longer usable. GSA states that the time of removal and the costs associated therewith are so uncertain that no reasonable cost factor can be applied at this time. GTC also contends the Government's administrative costs of arranging for installation of interconnect devices, reviewing test plans from vendors and possible vendor removal or the transfer of ownership of presently installed cables and terminals must be evaluated and the difference added to the price of purchased equipment. GSA responds that any such costs are either preaward selection costs or do not vary significantly whether the equipment is purchased or leased. In our opinion, such costs are too speculative or indefinite to provide a proper basis for evaluation factors. 43 Comp. Gen. 60, supra.

Accordingly, the protest is denied.

R.F.Keller

Deputy Comptroller General
of the United States