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**United States Government Accountability Office  
Washington, DC 20548**

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## **Decision**

**Matter of:** ERC, Inc.

**File:** B-404721; B-404721.2

**Date:** April 19, 2011

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Robert J. Symon, Esq., and Daniel P. Golden, Esq., Bradley Arant Boult Cummings LLP, for the protester.

J. Andrew Watson III, Esq., Stephen D. Davis II, Esq., and L. Justin Burney, Esq., Maynard Cooper & Gale, P.C., for AI Signal Research, Inc., an intervenor.

Tina Marie Pixler, Esq., and Dennis J. Gearin, Esq., Department of the Army, for the agency.

Linda C. Glass, Esq., and Sharon L. Larkin, Esq., Office of the General Counsel, GAO, participated in the preparation of the decision.

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### **DIGEST**

Protest challenging cost realism analysis is denied, where agency performed a comprehensive analysis of all major cost elements and relied on reviews and recommendations by the Defense Contract Audit Agency to reasonably determine that proposed costs were realistic for the work to be performed.

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### **DECISION**

ERC, Inc., of Huntsville, Alabama, protests the award of a contract to AI Signal Research, Inc. (ASRI), also of Huntsville, under request for proposals (RFP) No. W31P4Q-09-R-0008, issued by the Department of the Army, U.S. Army Material Command, for support services for the Redstone Test Center's Environmental and Component Test Directorate. ERC, the incumbent, challenges the agency's cost realism evaluation.

We deny the protest.

### **BACKGROUND**

The Army issued the RFP on March 20, 2009, as a competitive small business set-aside. RFP at 2. The RFP provided for award of a cost-plus-fixed-fee indefinite-delivery/indefinite-quantity contract for a 12-month ordering period with four successive 12-month ordering periods, for a total performance period of 60 months. Id. The RFP provided that award of the contract would be made on a

best value basis, considering the following factors: business management and technical, past performance, and cost. Id. at 108, 112. The business management and technical factor consisted of subfactors for oral presentation and an impromptu task. Id. at 108. The RFP provided that the business management and technical factor was significantly more important than the past performance and cost factors combined, and that the past performance factor was more important than the cost factor. Id. The RFP further provided that the oral presentation subfactor was more important than the impromptu task subfactor. Id.

The RFP instructed offerors that the cost analysis would be accomplished by evaluating each proposal's most probable cost (MPC) to the government. The RFP defined MPC as the government's "estimation of the cost of completing the contract using the offerors['] proposed approach." Id. at 111. The RFP stated that offerors' proposed rates, factors, and expenses would be examined by the Defense Contract Audit Agency (DCAA) or any other means determined appropriate by the government. Id. The RFP specifically provided that, in determining the MPC:

The government will evaluate the Contractors overall ability to support the task order requirements with highly qualified personnel as evidenced by the proposed rate structure. The evaluation will include a cost realism analysis utilizing comparisons to the historical composite rate adjusted for anticipated future changes and/or similar rates under comparable government contracts performed in local area. The government will consider failure to provide comparable rates as an indicator of risk associated with the contractors understanding of the requirements of the Performance Work Statement. Rate structures considered too low to recruit and retain highly qualified personnel may indicate increased cost risk which will be considered in the source selection decision.

Id. at 111-12. The RFP further stated that the agency would rely upon local market wage rates and labor rates of similar government contracts in developing the MPC and in making trade-offs in determining the best value proposal. Id. at 112.

Lastly, the RFP included, "for information purposes only," government-developed "Subtotal Unburdened Hourly Rate[s]" and "Subtotal Unburdened Overtime Hourly Rate[s]" for each ordering period. Id. at 105, 112. The RFP stated that these rates were developed based on historical labor cost data adjusted for anticipated future changes. Id. at 105. The RFP stated that offerors proposing less than these rates were required to "fully justify the deviation." Offerors were warned that the "[f]ailure to provide complete and convincing substantiation may indicate unrealistic labor rates and result in an assessment of increased cost risk" to their proposals. Id.

Five proposals, including ERC's and ASRI's, were received and evaluated by the source selection evaluation team. The evaluation results with respect to the protester and ASRI were as follows:

<b>Offeror</b>	<b>Business Management/ Technical</b>	<b>Past Performance</b>	<b>Proposed Cost</b>	<b>MPC</b>
ERC	Excellent	Low Risk	\$199,165,429	\$205,505,821
ASRI	Good	Low Risk	\$177,004,995	\$183,752,869

Agency Report (AR), Tab C, Source Selection Decision, at 7.

With respect to the cost evaluation, DCAA and the agency's price analyst evaluated the offerors' proposed direct and indirect labor rates, attrition and escalation factors, and other costs. The price analyst relied heavily on DCAA's findings when making MPC adjustments, and also compared offerors' proposed composite labor rates with the composite rates furnished in the RFP. AR, Tab I, MPC Analysis of ASRI's Proposal, at 2; Tab O, MPC Analysis of ERC's Proposal, at 2-3. In this regard, both offerors deviated, to some extent, from the RFP-provided composite rates. AR at 4.

For ASRI's proposal, DCAA recommended changes to some direct labor rates, and the application of an escalation factor to ASRI's direct labor rates for ordering periods two through five.<sup>1</sup> DCAA also recommended that ASRI's proposed attrition rate be decreased to [DELETED] percent and applied to period one only.<sup>2</sup> AR, Tab K, DCAA Audit Report for ASRI, at 7-9.

For ERC's proposal, DCAA recommended adjustments to ERC's direct labor costs, and the application of an escalation factor to ordering periods two through five. DCAA also found that ERC was proposing fringe rates and a general and administrative (G&A) structure that were inconsistent with its established practice; accordingly, DCAA used a linear regression analysis to determine ERC's fringe and G&A rates, which resulted in an upward adjustment to ERC's MPC. AR, Tab P, DCAA Audit Report for ERC, at 8-9.

The price analyst accepted the recommendations of DCAA, made adjustments to the offerors' MPCs, and forwarded the cost evaluation to the source selection authority (SSA). The SSA reviewed the cost evaluation and determined that the difference between ERC's proposed costs and MPC was 3.2 percent, which indicated some performance risk. The SSA also noted that the most significant adjustment to ERC's

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<sup>1</sup> ASRI proposed zero escalation for all five ordering periods. AR, Tab K, DCAA Audit Report for ASRI, at 8.

<sup>2</sup> ASRI proposed a [DELETED] percent attrition rate for all five ordering periods. AR, Tab K, DCAA Audit Report for ASRI, at 8. A higher attrition rate has the practical effect of lowering direct labor rates because new hires are generally brought in at lower rates than existing employees.

MPC was in the application of fringe rates. AR, Tab C, Source Selection Decision, at 13.

In comparison, the SSA noted that the difference between ASRI's proposed costs and MPC was 3.8 percent, which indicted to the SSA a "similar level of performance risk." Id. The SSA recognized that ASRI's MPC adjustments were primarily due to DCAA's reduction of the attrition factor and application of the factor to only ASRI's first ordering period labor rates, and DCAA's application of an escalation factor to ASRI's direct labor. Id.

The SSA noted the ASRI's cost proposal was consistent with the historical composite rate and presented low risk to the government in terms of recruiting and retaining highly qualified personnel. The SSA concluded that ASRI was "highly capable and qualified to provide excellent support," and that the technical differences between ERC's and ASRI's proposals "do not indicate that there would be a significant difference in contract performance." Although recognizing that the business management and technical factor was significantly more important than the cost factor, the SSA determined that the technical superiority of ERC's proposal was not worth paying the "significant cost premium" of approximately \$21.7 million. Id. at 13-14.

The SSA selected ASRI's lower-cost proposal for award and, on December 27, 2010, ASRI was awarded the contract. After a debriefing, ERC filed an initial protest with our Office on January 10, 2011, and ERC supplemented that protest on February 22.

## DISCUSSION

ERC challenges the agency's cost realism analysis of both ASRI's and ERC's proposal and maintains that the MPC adjustments were unreasonable.

When an agency evaluates a proposal 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. Federal Acquisition Regulation (FAR) §§ 15.305(a)(1); 15.404-1(d); Tidewater Constr. Corp., B-278360, Jan. 20, 1998, 98-1 CPD ¶ 103 at 4. Consequently, the agency must perform a cost realism analysis to determine the extent to which an offeror's proposed costs are realistic for the work to be performed. FAR § 15.404-1(d)(1). An agency is not required to conduct an in-depth cost analysis, see FAR § 15.404-1(c), or to verify each and every item in assessing cost realism; rather, the evaluation requires the exercise of informed judgment by the contracting agency. Cascade Gen., Inc., B-283872, Jan. 18, 2000, 2000 CPD ¶ 14 at 8. Further, an agency's cost realism analysis need not achieve scientific certainty; rather, the methodology employed must be reasonably adequate and provide some measure of confidence that the rates proposed are reasonable and realistic in view of other cost information available to the agency as of the time of its evaluation. See SGT, Inc., B-294722.4, July 28, 2005, 2005 CPD ¶ 151 at 7; Metro Mach. Corp.,

B-295744, B-295744.2, Apr. 21, 2005 CPD ¶ 112 at 10-11. Because the contracting agency is in the best position to make this determination, we review an agency's judgment in this area only to see that the agency's cost realism evaluation was reasonably based and not arbitrary. Hanford Env'tl. Health Found., B-292858.2, B-292858.5, Apr. 7, 2004, 2004 CPD ¶ 164 at 10.

#### ASRI's Evaluated MPC

ERC contends that the cost realism analysis of ASRI's proposed costs was unreasonable. ERC argues that ASRI deviated significantly from the composite labor rates set forth in the RFP and that ASRI failed to substantiate its deviations. Protest at 3-7; Supplemental Protest and Comments at 9-13. ERC further argues that the agency's application of an attrition rate to ASRI's labor costs was not reasonable and deviated from the requirements of the RFP. Comments at 21-23. As discussed below, the protester's arguments provide no basis to sustain the protest.

With regard to ERC's assertion that ASRI deviated from the composite rates, we note that the composite rates provided in the RFP were "[f]or information purposes only," and offerors were permitted to deviate from these rates with adequate justification. RFP at 105, 112. The agency reports that both ERC and ASRI deviated from the historical average pay rates for several labor categories. AR at 4. The agency explains that ASRI deviated by proposing lower rates for 6 of the 30 non-management labor categories.<sup>3</sup> AR at 5; Contracting Officer Statement at 8. ASRI explained that its labor rates were developed using the historical average pay rates provided in the RFP and actual rates of current ASRI employees in each labor category. AR, Tab J, ASRI Cost Proposal, at 18. ASRI also documented that it [DELETED] to fill positions for this effort. Id. at 26. ASRI offered several justifications for its lower labor rates, to include: high unemployment and layoffs will result in lower wage rates; good benefits will result in a willingness to forego wage increases; and promotions from within the organization will allow ASRI to fill vacated positions with less senior people at lower wages. Id. at 27-28.

Both DCAA and the agency found ASRI's rates to be reasonable, given that 5 of the 6 rates that deviated downward from the RFP-provided rates were based on the hourly rates of current ASRI employees working under very similar conditions. (The 6th rate was adjusted downward based on a local wage survey.) AR, Tab K, DCAA Audit Report for ASRI, at 7; see also AR at 5. Moreover, the record shows that the cost evaluation did result in certain upward adjustments to ASRI's rates to reflect the average actual direct labor rates for the labor categories where incumbent employees were performing. AR, Tab K, DCAA Audit Report for ASRI, at 7;

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<sup>3</sup> ASRI's proposed labor rates for the remaining 24 non-management labor were either at or above the RFP-provided composite rates, and are not challenged in this protest. AR at 5; Contracting Officer's Statement at 8.

Contracting Officer's Statement at 9. Based on this record, we find no basis to conclude that the agency's evaluation of ASRI's labor rates was unreasonable.<sup>4</sup>

With regard to attrition rate, the record shows that ASRI proposed an attrition rate of [DELETED] percent for all five performance periods, and DCAA applied a lower rate of [DELETED] percent to the first period only. AR, Tab K, DCAA Audit Report for ASRI, at 8. DCAA based its lower rate on ASRI's experience in performing a contract similar in scope to this requirement. The agency adopted DCAA's recommendation in this area, which resulted in a downward reduction of approximately [DELETED], or [DELETED] of a percent, in ASRI's MPC. AR, Tab I, MPC Analysis of ASRI's Proposal, at 2; Supplemental AR at 3. If this attrition rate were not applied, the difference in MPCs between ERC's and ASRI's proposals would be [DELETED], rather than [DELETED]. Supplemental AR at 3. Given the small impact attributable to the application of an attrition rate on ASRI's MPC, the protester has not shown that it was prejudiced, even if the application of the attrition rate was in error. See Armorworks Enters., LLC, B-400394.3, Mar. 31, 2009, 2009 CPD ¶ 79 at 3.

#### ERC's Cost Evaluation

ERC also argues that the agency unreasonably increased its fringe rates in the MPC analysis. Specifically, ERC contends that the adjustments were based on an inappropriate application of linear regression analysis. Protest at 7-8; Supplemental Protest and Comments at 16-19.

The upward adjustments of ERC's fringe rates were due to DCAA recommendations. In this regard, DCAA questioned ERC's proposed fringe rates because they were inconsistent with the firm's established practices. When questioned about this disparity, ERC responded that "its proposed method for allocating fringe costs is not necessarily how it will be accounting for them." AR, Tab P, DCAA Audit Report of ERC, at 9. DCAA therefore projected ERC's fringe rates for 2009 using a linear regression analysis, based on historical data from 2005 to 2008 of the actual fringe rates incurred by ERC on a contract of similar scope to the requirement here. This

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<sup>4</sup> The protester further argues that the agency's technical evaluation was flawed because it did not take into account ASRI's proposed labor rate deviations, or the impact of the deviations on ASRI's ability to recruit and retain personnel. Supplemental Protest and Comments at 13-15, 19-21. However, as discussed above, we find no error in the agency's evaluation of ASRI's proposed labor rate deviations, and the SSA affirmatively determined that ASRI demonstrated the ability to recruit and retain capable personnel. AR, Tab C, Source Selection Decision, at 11. ERC has not shown the SSA's conclusion, or the technical evaluation, to be unreasonable.

resulted in an upward adjustment to ERC's proposed fringe rates of between .3 and 1.1 percent for each of the ordering periods.<sup>5</sup> Id.<sup>6</sup>

The agency explains that, when there is a good correlation between historical pools and bases (as is the case here), linear regression is a better predictor of future overhead rates than new contract specific rates with no historical bases. According to the agency, linear regression is one of the techniques most commonly used to quantify the relationship between indirect cost rate bases and pools over time. Contracting Officer's Statement at 11.

ERC does not disagree with this premise, but argues that the use of linear regression here was not appropriate because the agency provided, as part of the RFP, "a proportion of future hours . . . that differed significantly from the historical experience of ERC as the incumbent contractor." Supplemental Protest and Comments at 18. Consequently, it is ERC's position that the increase in the RFP-mandated hours has the effect of lowering its fringe rates. Id. at 16.

The protester has not shown that DCAA's use of the linear regression technique was unreasonable here. Since ERC failed to provide DCAA with an adequate explanation for proposing fringe rates that were different from what it was currently using, DCAA reasonably used an evaluation technique that relied on ERC's actual performance to determine ERC's fringe rates--a technique that all parties agree is a good predictor of overhead rates when there is a good correlation between historical pools and bases. Id. at 18; Contracting Officer's Statement at 11. Given that the RFP advised offerors that rates would be examined by DCAA, and given that DCAA's analysis of ERC's fringe rates was reasonable, we have no basis to question the agency's following of DCAA's recommendation to upwardly adjust ERC's fringe costs in the MPC evaluation. See Systems Research Corp., B-237008, Jan. 25, 1990, 90-1 CPD ¶ 106 at 5 (agency reasonably may rely on DCAA's rate checks in connection with a cost realism analysis).

The protests are denied.

Lynn H. Gibson  
General Counsel

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<sup>5</sup> According to the protester, this resulted in an upward MPC adjustment of [DELETED]. Supplemental Protest and Comments at 18.

<sup>6</sup> The agency also upwardly adjusted ERC's proposed G&A rates, based on DCAA's recommendation and linear regression analysis. Contracting Officer's Statement at 10.