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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

LOGISTICS AND COMMUNICATIONS
DIVISION

B-164250

FEB 27 1973

The Honorable Elliot L. Richardson
The Secretary of Defense

Dear Mr. Secretary:

We looked into the manner in which the Army awarded and administered advertised, fixed-price contract DACA 87-70-C-0013 in the amount of \$138 million with the Morrison-Knudsen Company and Associates. The contract was for constructing SAFEGUARD Anti-Ballistic Missile System technical facilities at the first deployment site near Grand Forks Air Force Base, North Dakota. On July 18, 1972, we sent you a draft of our proposed report for review and comment. By letter to us dated September 28, 1972, you replied and transmitted detailed comments of the Army (OSD Case 3502).

We have given careful consideration to your comments and to the intended actions of the Corps of Engineers. We have given particular attention to the unique nature of this procurement, including the urgency given by the executive branch to expedite the construction and the subsequent cutback of the program from several sites to one site. In view of this and considering that the major contract changes have not yet been resolved financially, we have decided not to submit a formal report to the Congress.

CONTRACT INFORMATION

The Corps of Engineers awarded this contract even though it knew that many revisions would be needed for approved changes in design and specifications and for correcting errors, omissions, and discrepancies. As a result, more than 75 percent of the 4,500 drawings were changed. Many of the construction design changes occurred because the weapon system design had not yet been firmed up and was being revised concurrently with the construction.

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The Corps decided that the contract would have to be awarded by April 1, 1970, as was done, to meet a target date for occupancy of the facilities which was set by the SAFEGUARD System Manager.

To cover the cost of the change order for the required changes known to the Army at the time of award, the contractor subsequently claimed \$43 million. The complexity of this change order and its relationship to other subsequent changes have contributed to delays of more than 2 years in negotiating the change order prices. Also the problem of obtaining pertinent cost or pricing data supporting the contractor's proposals has been one of the major factors in delaying negotiation of change orders.

As of December 1972 negotiated change orders had increased the original contract price of \$138 million by about \$5.7 million. At that time, however, when the work under the contract was 98 percent complete, price proposals submitted by the contractor but unnegotiated totaled \$109 million and price proposals for many more change orders had not yet been received. The fact that a large part of the contract will not be priced until after the costs have been incurred has tended to transfer cost risk from the contractor to the Government and has reduced the contractor's incentive to keep costs down.

PRIOR REPORT REGARDING SIMILAR CONTRACTING

We pointed out in our draft report that the circumstances of the contract award were similar to those discussed in our 1963 report to the Congress on the administration of construction of certain launch facilities for the ATLAS and TITAN Intercontinental Ballistic Missiles at selected Air Force bases.

As discussed in the 1963 report, the Corps awarded advertised, fixed-price contracts but the contract specifications were so incomplete and the requirements were modified so frequently and extensively that the Corps had to abandon the fixed prices and negotiate final prices on the basis of costs claimed by the contractors for the work performed. As a result, price benefits normally associated with the use of advertised, fixed-price contracts were nullified.

AGENCY COMMENT

The Army concluded, prior to advertising, that the plans and specifications for the SAFEGUARD facilities were adequate for preparing a bid and awarded the contract with the full realization that a majority of the drawings would require revision.

The Army's principal reasons for deciding to award an advertised, fixed-price contract were that:

- The bid package was essentially complete with respect to system delineation and was acceptable for fixed-price bidding.
- The contract provided maximum incentive for the contractor to control costs.
- The contract provided maximum incentive for the contractor to allocate its best management talent to the job.

Concerning the contractor's price proposals for change orders, the Army stated that it is not unusual for contractors to submit exorbitant claims which are subsequently determined to be invalid. The Army expects that final negotiations will prove this to be the case on this contract.

The Army said that the Corps does not intend to settle this contract on the basis of costs claimed by the contractor. Rather, the Corps intends to insist on and use pertinent cost and pricing data in the negotiation of the change orders.

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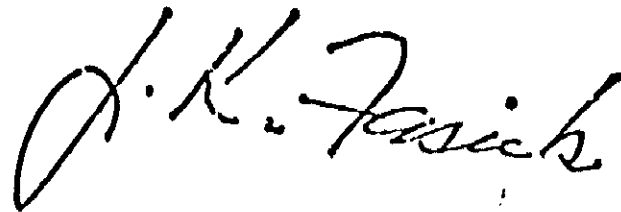
We agree with the Corps' intended action and, therefore, have no recommendation. Considering, however, the large amounts of the contractor's claims and the difficulties which the Corps has experienced in obtaining the requested cost and pricing data, we believe that your office may want to insure that the change orders are settled on the basis of adequate consideration of cost and pricing data.

In the future we may look into the effectiveness of the negotiations to settle the change orders.

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We are sending copies of this letter to the Director, Office of Management and Budget; the Secretary of the Army; the Director, Defense Contract Audit Agency; and the Division Manager, Morrison-Knudsen Company, Inc.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "J. K. Fasic". The signature is written in black ink and is positioned above the printed name "Director".

Director