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

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MAY 11 1976

The Honorable Robert L. Sikes  
Chairman, Subcommittee on Military  
Construction  
Committee on Appropriations  
House of Representatives



Dear Mr. Chairman:

As you requested, we have reviewed the contracting procedures the Ogden Air Logistics Center, Ogden, Utah, used to award contract number F4-2600-76-C-0250 to E-Systems for programed depot maintenance services for F-4C aircraft. This contract, awarded in the amount of \$3,377,320, has a potential value of \$15,497,652. Another bidder, Fairchild Industries, Inc., questioned the evaluation formula used to determine the low offeror. *565* *CMB 01972*

We made our review primarily at Ogden. We examined contract files, reports, and other agency records; procurement policies and procedures; and documents submitted by Fairchild Industries, Inc. Although we did not consider it necessary to obtain formal comments, we did discuss pertinent matters with knowledgeable officials of both Fairchild and the Air Force. We considered their comments in preparing this report.

Our objective was to determine whether the evaluation formula used in the request for proposals had resulted in the lowest overall cost to the Government. We found that the solicitation issued for this procurement provided an equitable basis for evaluating proposals. The evaluation formula included all factors needed to properly determine the low offeror. However, the solicitation and resulting contract provided for an undesirably large amount of work for which fixed prices were not established. As a result, it was not possible at the time of award for Ogden to determine the ultimate overall cost to the Government. We believe that, for future procurements of maintenance services, the procurement activity should try to considerably increase the amount of work covered by detailed specifications and fixed prices.

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BACKGROUND

Ogden is responsible for providing programed depot maintenance services for the F-4C aircraft. Normally the depot maintenance activity at Ogden does such maintenance; however, Ogden determined, due to a lack of manpower, that it would be unable to provide these services after fiscal year 1975. As a result, Ogden initiated procurement of the services for fiscal years 1976 through 1980.

Programed depot maintenance involves two types of work--basic and "over and above." Basic work is work that can be determined as applicable to all aircraft before the maintenance is programed. The over-and-above work is work that can be determined only after a detailed inspection is made of each aircraft. There are two categories of over-and-above work: (1) work for which technical data can be furnished and the number of times the repair will be required can be estimated and (2) work for which only general specifications can be provided. For the latter category, contractors are required to quote only an hourly rate, rather than a fixed price, for the work to be done.

FAIRCHILD'S ALLEGATIONS

Fairchild alleged that the evaluation formula Ogden used to select the low offeror was inequitable, deficient, and not in accordance with the Armed Services Procurement Regulation. Fairchild alleged that this formula did not meet the requirements of sections 3-801.1 and 3-807.1 of the regulation.

Section 3-801.1 states, in part, that:

"It is the policy of the Department of Defense to procure supplies and services from responsible sources at fair and reasonable prices calculated to result in the lowest ultimate overall cost to the Government."

Section 3-807.1 states, in part, that:

"price competition may be presumed to be adequate unless the purchaser \* \* \* finds

- (i) the solicitation was made under conditions that unreasonably deny to one or more known and qualified offerors an opportunity to compete;
- (ii) the low competitor has such a determinative advantage over the other competitors that he is practically immune to the stimulus of competition in proposing a price \* \* \*."

Fairchild asserted that the large number of labor-hours estimated for the over-and-above work caused the apparent low offeror to be determined by the lowest hourly labor rate submitted. Fairchild maintained that this method of evaluation did not consider the production efficiencies of the respective offerors nor the fact that skills making up direct labor pools would vary among the offerors. In addition, Fairchild questioned the propriety of defining direct labor in the solicitation. This definition was allegedly contrary to the general provisions of the solicitation, because these provisions required a contractor to follow its disclosed cost accounting practices. The likelihood was that the disclosed cost accounting practices differed from the definition in the solicitation. Therefore Fairchild concluded that this solicitation was defective.

CONTRACTING PROCEDURE COMPLIED WITH  
REQUIREMENTS OF THE ARMED SERVICES  
PROCUREMENT REGULATION

The contracting procedure Ogden used generally complied with the regulation's requirements. The solicitation described the basis on which the proposals would be evaluated. Using this basis, the procurement office attempted to select the lowest ultimate cost to the Government. Further, each offeror was instructed to propose an hourly rate for the over-and-above work based on the definition of direct labor in the solicitation. This was to prevent variances that might occur in computing the hourly rate due to differences in accounting classifications for direct and indirect labor.

Solicitation provided an adequate basis for bidding and for evaluating proposals

The solicitation included technical data describing the basic work and required offerors to propose fixed prices for that work. The offerors were also required to propose fixed prices for that part of the over-and-above work for which technical data could be furnished and the frequency of each repair could be estimated. For the remainder of the over-and-above work, for which only general specifications outlining the nature of the work could be provided, the offerors were required to propose hourly rates based on Ogden's estimate of the number of hours that would be required. The solicitation stated that this rate would cover all charges for direct and indirect labor, indirect parts and materials, overhead charges, and profit. Payment for the over-and-above work was to be based on the labor rate multiplied by the number of direct labor-hours negotiated by the contractor and the contracting officer after the work requirements were more fully defined through completion of work on a number of of aircraft.

For computing a labor rate for the over-and-above work, the solicitation defined direct labor as being labor by direct productive personnel and not work by such nonproductive personnel as timekeepers, payroll clerks, and executives.

The cost accounting standards provision of the solicitation required the successful contractor to submit a revised disclosure statement if its previously disclosed definition of direct labor differed from the definition in the solicitation. Ogden officials explained the definition of direct labor during a preproposal conference and advised the offerors, including Fairchild, that the definition was necessary to provide a basis for equitable evaluation of the fixed hourly rates proposed for the over-and-above work and to provide a basis for payment. An offeror who assumed that the rate would be applied to all labor-hours incurred, both productive and nonproductive, undoubtedly would have proposed an unrealistically low rate.

Evaluation formula

The formula Ogden used to determine the low offeror evaluated the prices proposed for the two different types of work.

Although offerors were required to propose prices for all 5 program years, evaluation was based on the prices proposed for the first 3 program years only. The evaluation formula considered the following criteria to determine the low offeror.

- The total of the fixed prices proposed for the basic work.
- The total of the fixed prices proposed for the fixed-price over-and-above work.
- The fixed hourly rates proposed for the fixed-hourly-rate over-and-above work.

To ascertain an offeror's proposed price for the fixed-hourly-rate over-and-above work, the offeror's proposed hourly rate was multiplied by Ogden's estimate of the total direct labor-hours required for that work.

Ogden procurement officials maintained, and we agree, that the production efficiencies related to the fixed-hourly-rate over-and-above work could not be considered by the evaluation formula, because there was no equitable method to set the level of efficiency for each offeror. This efficiency can be determined only after a task is completed.

LOW OFFEROR DID NOT PROPOSE  
LOWEST HOURLY LABOR RATE

Contrary to Fairchild's contention, the overall low offeror was not the offeror who submitted the lowest hourly rate for the over-and-above work. Fairchild, which was the second overall low offeror, proposed the lowest hourly rate. The low offeror, E-Systems, proposed hourly rates that were from \$0.19 to \$2.13 higher than Fairchild's rates. However, E-Systems won the award by offering considerably lower prices than Fairchild for the fixed-price work required by the solicitation.

LABOR-HOUR CONTRACTING METHOD UNDESIRABLE

Although the regulation provides for labor-hour contracts, care should be exercised in using this type of contract, because it does not afford the contractor any positive profit incentive to manage its labor force effectively. Moreover, the regulation states that it is essential that adequate controls, including appropriate surveillance by Government personnel during performance, be used to give reasonable assurance that inefficient and wasteful methods are foreclosed.

About 65 percent of the total work required for the first 3 years of this contract, an undesirably large amount in our opinion, was composed of fixed-hourly-rate over-and-above work. Therefore the administrative contracting officer will be responsible for negotiating most of the final price on a sole-source basis. Ogden officials agreed that this contract included an undesirable amount of over-and-above work but argued that there was no way any of this work could have been included in the fixed-price part of the contract.

According to Ogden officials, not all the work currently included in the fixed-hourly-rate over-and-above category will remain such during contract performance. They disclosed that they had an agreement with E-Systems to negotiate a fixed price for part of the over-and-above work after completion of four aircraft. Thus the contracting parties will negotiate to greatly reduce the over-and-above work.

We pointed out to Ogden officials that the contract did not provide that fixed prices be negotiated for over-and-above work. In our opinion, the contract should have included such a provision. Ogden officials agreed and stated that such a provision would be included in future procurements of this type.

RECOMMENDATION

We recommend that, in contracting for future maintenance service for F-4C aircraft or for similar work for other aircraft, the Secretary of the Air Force reduce the amount of work that is contracted for on an over-and-above basis to the maximum extent possible.

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Since Ogden has been doing this type of depot maintenance on the F-4C aircraft for about 15 years, we believe that it should be able to develop, in advance of contract performance, detailed specifications for a greater part of the work requirements.

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As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House and Senate Committees on Government Operations not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report. We will be in touch with your office in the near future to arrange for release of the report so that the requirements of section 236 can be set in motion.

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*S 00300*

Sincerely yours,



Comptroller General  
of the United States