



COMPTROLLER GENERAL OF THE UNITED STATES
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Dear Mr. Crowell:

In the analysis accompanying your letter to me of September 19, 1979, and in our September 25 meeting, you have taken exception to a recent report by GAO's Procurement and Systems Acquisition Division to Congressman Thomas H. Luken concerning the [procurement of depleted uranium penetrators]. This report (PSAD-79-88, June 13, 1979) concluded that it would be more economical for the Air Force to have the penetrator work performed by a Government-owned, contractor-operated (GOCO) facility--the Feed Materials Production Center*--rather than by the existing contractors--Aerojet-General Corporation and Honeywell, Inc. This conclusion was based on a comparison of the GOCO plant's "out-of-pocket" costs for the penetrator production with the full costs incurred by the existing contractors.

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Your primary objection is that the GAO report's out-of-pocket cost analysis with respect to the GOCO facility violates OMB Circular No. A-76 (Revised, March 29, 1979). Specifically you maintain that the report in effect recommends a "new start" of a GOCO facility, and therefore requires, under the terms of Circular A-76, a full cost analysis for the GOCO as well as the existing contractors.

Our Office of General Counsel considered this issue during its review of the report and concluded that the recommendation to use the Feed Materials Production Center for the penetrator work did not come within the rather narrow range of GOCO matters covered by the Circular, i.e., a "new start" or "expansion" of a GOCO facility was not involved. Since we regarded revised Circular A-76 as being inapplicable, it was not discussed in the report.

*/ The Center, located at Fernald, Ohio, is operated by the National Lead Company of Ohio under the aegis of the Department of Energy.

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In response to your contentions, our Office of General Counsel has taken another look at the A-76 issue. Enclosed is a copy of its analysis, which discusses the evolution and final language of the Circular with respect to GOCO operations and reaffirms its earlier conclusion that the Circular does not apply to the instant report recommendation. I agree with this analysis.

As discussed at our meeting, we have very little to add concerning your other objections to the report. An augmentation of funds or "subsidy" issue under 31 U.S.C. §628 would arise only to the extent that costs required to be apportioned between Air Force and Energy Department appropriations are not shared. Thus how one resolves the A-76 issue in terms of how the costs should be calculated is the primary consideration for this issue as well. In any event, there are differences between costing requirements for comparison purposes and for such purposes as appropriation account and implementation of the Cost Accounting Standards Act. See, e.g. Olin Corporation, 57 Comp. Gen. 209, 78-1 CPD 45(1978). Our conclusions concerning the Air Force Arsenal Statute and the Atomic Energy Act are fully explained in the attachment to the GAO report and need no elaboration here. Finally, the practical viability of the GAO recommendation from the GOCO plant's viewpoint is best left for it to determine.

I trust that the foregoing will clarify the premise underlying our report on the A-76 issue. I am sending copies of this letter, together with your memorandum, to Congressman Luken and to the agencies which received copies of our report.

Sincerely yours,

R. F. KELLER

Robert F. Keller
Deputy Comptroller General
of the United States

Enclosure

APPLICABILITY OF OMB CIRCULAR NO. A-76
(REVISED, MARCH 29, 1979), "POLICIES
FOR ACQUIRING COMMERCIAL OR INDUSTRIAL
PRODUCTS AND SERVICES NEEDED BY THE
GOVERNMENT," TO GOVERNMENT-OWNED,
CONTRACTOR-OPERATED (GOCO) FACILITIES

Prior to the March 1979 revision, OMB Circular No. A-76 had no application whatever to GOCO operations. It addressed Government "make-or-buy" decisions in the context of "in-house" performance (i.e., the Government owning and operating a particular facility or activity) versus contracting out to a contractor-owned, contractor-operated activity. The Circular made no attempt to deal with the hybrid category of GOCO facilities. The final March 1979 Circular as published in the Federal Register, 44 Fed. Reg. 20556 (April 5, 1979), recognizes that a GOCO operation is distinct from either in-house or straight contract performance, ^{*/} but does treat GOCO determinations to a limited extent.

^{*/} A GOCO facility clearly does not fit the definition in section 5 of the Circular, 44 Fed. Reg. 20558, of either a "Government commercial or industrial activity" ("* * * one which is operated and managed by a Federal executive agency * * *") or a "private commercial source" ("* * * a private business, university, or other non-Federal activity * * *"). Other provisions of the Circular likewise recognize that a GOCO operation is not the same as either an "in-house" or contract operation. Thus section 10(d)(3) of the Circular, 44 Fed. Reg. 20561, observes with respect to new starts:

"When Government ownership of facilities is necessary, the possibility of contract operation must be considered before in-house performance is approved as a new start. If justification for Government operation is dependent on relative cost, the comparative cost analysis may be delayed to accommodate the lead time necessary for acquiring the facilities."

See also, section 8(b)(2) of the Circular, 44 Fed. Reg. 20559:

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The origins of the revised Circular can be traced back to a series of proposed actions published in the Federal Register on November 21, 1977, 42 Fed. Reg. 59814. One of these proposed actions was to bring certain GOCO decisions within A-76 coverage:

"Require Government-owned, contractor-operated (GOCO) activity management to apply A-76 policy principles to in-house vs. contract considerations; also, require that in-house aspects of GOCO activities (ownership and related management) be considered as Government C/I [commercial/industrial] activity subject to A-76 review requirements." 42 Fed. Reg. at 59818.

The rationale underlying this proposed action was also set forth as follows:

"Current provisions of Circular A-76 specifically exclude GOCO activities from the definition of a Government commercial or industrial activity which is subject to review and justification. This exclusion is based on the fact that con-

*/ Footnote cont'd.

"A Government commercial or industrial activity providing depot or intermediate level maintenance may be justified in accordance with criteria approved by the Secretary of Defense to ensure a ready and controlled source of technical competence and resources necessary to meet military contingencies. * * * Justification under these criteria will require a detailed explanation, on a case-by-case basis, why the needed capability cannot be supplied by:

- (a) A private commercial source; or
- (b) Contract operation of Government-owned facilities. * * *

tract operation involves a substantial degree of reliance on the private sector, which provides operating management as well as the entire work force. At the same time, however, GOCO facilities have many of the characteristics of a Government operation--public financing, tax-free land and facilities, minimal risk for the operating contractor, and no competitive incentive. These circumstances tend to cause GOCO operation managers to expand GOCO capabilities rather than to rely on commercial firm[s] for processed materials, subassemblies, and various services. To assure that these decisions are based on appropriate considerations of economy for the Government, GOCO activity managers should be required to apply the policy and cost comparison provisions of Circular A-76 to their make-or-buy decisions.

"The current exclusion of GOCO activities from the definition of commercial or industrial activity overlooks the matter of Government ownership--capital investment, withholding property from local tax rolls, assumption of financial risk, and facility management. While there are circumstances where Government ownership of plant or equipment is justified and necessary for national security, economic or other reasons, financing and furnishing off facilities may be available from the private sector either separately or as part of delivering a finished product or complete service. * * *.

"The current treatment of GOCO facilities in Circular A-76 permits an agency to make a commitment for capital investment and the risks of facility ownership, frequently subsidizing competition with

firms operating in the commercial marketplace, on the basis of an intent to make a cost study of contract vs. Government operations. The spirit and policy of Circular A-76 would call for some test of such a decision in regard to the public interest before assuring Government ownership of the necessary facility." Id. at 59818-19.

The same elements of GOCO coverage proposed in November 1977 were retained in a draft revision of Circular A-76 published in the Federal Register for August 22, 1978, 43 Fed. Reg. 37410. Thus section 5(c) of the August 1978 draft states:

"This Circular applies to the operation of Government-owned, contractor-operated (GOCO) facilities. The policies should be incorporated into the make-or-buy procedures of the operating contractor as an agent of the executive agency." 43 Fed. Reg. at 37411.

Also section 4(a) of this draft provides that the definition of a "Government commercial or industrial activity" includes "the facility and equipment ownership aspects of" a GOCO. Id.

The final revision of Circular A-76 was issued on March 29, 1979, and published in the Federal Register for April 5, 1979. The preamble to the final revision states with reference to GOCO applications:

"Government-owned, contractor-operated (GOCO) activities were excluded from the prior issuances of the Circular. A comprehensive review of all GOCO activities is necessary to determine whether they can be completely treated under the terms of this Circular. In the interim, this Circular is to be applied only to new starts and expansions of Government-owned equipment and facilities." 44 Fed. Reg. at 20557.

While the revised Circular still breaks new ground by asserting some GOCO coverage, the final version clearly represents a significant recession from the November 1977 and August 1978 proposals in terms of the extent of such coverage. The final version does not include any GOCO aspects within its definition of "Government commercial or industrial activity." And, rather than covering "the operation of" GOCO facilities as the August 1978 draft had proposed, section 6(c) of the final version states:

"This Circular applies to the need for Government ownership in any 'new start' or 'expansion' of a Government-owned, contractor-operated (GOCO) facility."
44 Fed. Reg. 20558 (emphasis added).

We assume for the moment that the Circular's statement of GOCO coverage in terms of any "new start" or "expansion" of a GOCO facility refers to its definitions of "new starts" and "expansions" of Government commercial or industrial activities, i.e., "in-house" operations. Section 5(d) of the Circular, 44 Fed. Reg. 20558, defines "new start" as follows:

"A 'new start' is a newly-established] Government commercial or industrial activity, including a transfer of work from contract to in-house performance. Also included is any expansion which would increase capital investment or annual operating costs by 100% or more."

Section 5(b) defines "expansion" as follows:

"An 'expansion' is the modernization, replacement, upgrade, or enlargement of a Government commercial or industrial activity involving additional capital investment of \$100,000 or more, or increasing annual operating costs by \$200,000 or more; provided, the increase exceeds 20% of the total investment or annual operating cost. A consolidation of two or more activities is not an 'expansion' unless the proposed total

capital investment or operating cost exceeds the total from the individual activities by the amount of the threshold. An expansion which increases either capital investment or annual operating cost by 100% or more is a 'new start.'

It seems clear that the above "new start" definition --whether applied either to a GOCO plant or to a Government-operated facility--turns upon the establishment of a new facility where none existed at the time (except in the case of a 100% expansion of an existing facility). This follows the consistent approach in the various OMB drafts and explanatory material of equating new starts with new or reactivated facilities, and expansions with increased investment levels at existing facilities. See, e.g., 44 Fed. Reg. 20556 (April 5, 1979); 43 Fed. Reg. 37410-11 (August 22, 1978); 42 Fed. Reg. 59817-18 (November 21, 1977). We interpret the phrase "including a transfer of work from contract to in-house performance" in the "new start" definition as insuring coverage in situations where a new facility is established solely to accommodate work being transferred from contract performance. We do not view this phrase as implying that the transfer of any project from contract performance to an already established facility would amount to a "new start." Such an interpretation would undermine the clearly intended distinction between a new start and expansion under the Circular. For example, this interpretation could make a "new start" out of work transferred from contract performance which would not even be of sufficient magnitude to constitute an "expansion" under the Circular's definition of that term.

The GAO recommendation in this case concerned the potential transfer of work from contract performance to an existing GOCO facility. Therefore, we did not view it as a "new start" for purposes of applying Circular A-76.

The remaining possibility is that the recommendation could involve an "expansion" of the existing GOCO plant and thereby trigger an A-76 review. However, it is our understanding that transferring the penetrator work to the Feed Materials Production Center could be accomplished without any real "modernization, replacement, upgrade, or enlargement" of the plant. Rather, the penetrator work would essentially take advantage of the

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plant's underutilized existing facilities. In this connection, our June 12 report observed that substantial savings were possible because production of the penetrators at the Center could be integrated with current DOE production without proportionate increases in overhead and labor costs. Therefore, the GAO recommendation does not involve an "expansion" of the facility for A-76 purposes.

The instant GAO recommendation does not rise to the level of a "new start" or "expansion" of a facility (GOCO or otherwise) within the definitions of OMB Circular A-76. Moreover, even if these definitions would be applicable in the case of a Government-operated facility, they might not apply to a GOCO plant. It is not at all clear how the specific mechanisms set out in the Circular, such as the cost comparison factors for in-house versus contract operation, are to be applied in relation to "the need for Government ownership" as a discrete issue. This may be why the preamble to the final Circular recognizes a need for further study of its application to GOCO operations and that, in the interim, only limited application is required.

In sum, application of OMB Circular A-76 to the instant GAO recommendation is not required by the language or purposes of the Circular.