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UNITED STATES  
GENERAL ACCOUNTING OFFICE

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# REPORT OF THE COMPTROLLER GENERAL OF THE UNITED STATES



## Procurement Of Rail Passenger Cars For The New Haven Railroad

Urban Mass Transportation Administration  
Department of Transportation

The Urban Mass Transportation Administration granted Connecticut \$49.6 million to assist in purchasing 100 passenger cars from General Electric for \$63.9 million. The procurement contract did not adequately protect Federal interests and the Government probably will incur interest costs of about \$2 million by funding the contractor in advance.

Although the Urban Mass Transportation Administration acted to protect the Government, GAO believes that the agency's interpretation of its directives, patterned after the Federal procurement standards for grantees, resulted in limiting the direction the agency provided in this grant. Federal agencies currently are reviewing these standards. GAO recommends that more specific grantee contracting procedures be developed.

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SEPT. 17, 1975

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COMPTROLLER GENERAL OF THE UNITED STATES

WASHINGTON, D.C. 20548

B-107449

The Honorable  
The Secretary of Transportation 29

Dear Mr. Secretary:

This is our report entitled "Procurement of Rail Passenger Cars for the New Haven Railroad." Our review was made at the request of Governor (formerly Representative) Ella Grasso of Connecticut.

We invite your attention to the fact that this report contains recommendations to you which are set forth on page 22. As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement of the actions he has 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 are sending copies of this report to Governor Grasso; the Director, Office of Management and Budget; the Senate Committees on Appropriations, Government Operations, and Banking, Housing, and Urban Affairs; the House Committees on Appropriations, Government Operations, and Public Works and Transportation; and selected Members of Congress and other interested parties.

Sincerely yours,  
*Thomas P. Steeds*

Comptroller General  
of the United States

*Transportation Contracts  
Self source contracts  
New Haven Transportation  
1970-71  
funding*

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ABBREVIATIONS

CDOT	Connecticut Department of Transportation
GAO	General Accounting Office
GE	General Electric Company
GSA	General Services Administration
MTA	Metropolitan Transportation Authority (New York)
UMTA	Urban Mass Transportation Administration

COMPTROLLER GENERAL'S  
REPORT TO THE  
SECRETARY OF TRANSPORTATION

PROCUREMENT OF  
RAIL PASSENGER CARS  
FOR THE NEW HAVEN RAILROAD  
Urban Mass Transportation  
Administration  
Department of Transportation

D I G E S T

The Urban Mass Transportation Administration granted \$49.6 million to the Connecticut Department of Transportation in June 1974 to assist in purchasing 100 new passenger railcars for the New Haven Railroad under a sole-source contract amendment from the General Electric Company for \$63.9 million.

The Urban Mass Transportation Administration approved a third-party contract under which General Electric received \$42.8 million by September 1974 when it had incurred contract costs of only \$2.9 million. (See pp. 2 to 4, 8 to 10, and 14 and 15.)

The advance payments were made to enable General Electric to manufacture the railcars without borrowing. GAO believes that this goal could have been accomplished with a less liberal payment schedule. The payments were made without contractual provisions to protect the Government and the grantee.

The Urban Mass Transportation Administration approved the sole-source procurement without adequate assurances that General Electric had provided sufficient cost or pricing data or that data provided had been adequately analyzed. (See pp. 11 to 17.)

GAO recommends that the Urban Mass Transportation Administration develop more specific grantee contracting procedures, possibly patterned after the Federal Procurement Regulations, to insure that

--the awarding of contracts involving sole-source procurements is conducted and documented so that the price can be determined as fair and reasonable and

--the payments to contractors are made according to the principle of minimizing the time elapsed between the transfer of funds from the U.S. Treasury and the final use made of those funds.

GAO also recommends that the Urban Mass Transportation Administration develop procedures for documenting justification for sole-source procurements and all special contract conditions and payment provisions in third-party contracts. (See pp. 22 and 23.)

The Department of Transportation stated that although it agreed with certain specifics of the report, it did not agree with GAO's conclusions on the weaknesses in the contracting procedures used. (See pp. 18 and 19.)

Urban Mass Transportation Administration officials realized that the payment schedule could result in advances to General Electric and therefore required General Electric to limit its profit and pay interest on advances under certain conditions. (See p. 16.)

According to General Electric's cost forecast, costs will exceed the total \$63.9 million price. If this forecast holds true there will not be any refund and General Electric will have had use of the advances interest free. (See p. 18.)

Regardless of General Electric's final costs, the Federal Government will incur about \$2.1 million of additional interest costs in providing its share of those funds in advance of the amounts needed to meet the contractor's costs without borrowing. (See p. 17.)

Although the Urban Mass Transportation Administration's third-party contracting directives conform to the intent of Federal administrative requirements for grants to States, they do not provide enough specific criteria regarding certain procurement methods. (See pp. 9 and 11.)

The General Services Administration has established an interagency study group to review grantee procurement standards, and the Department of Transportation has appointed a representative to the study group.

The Department believes existing requirements do not provide Federal agencies with adequate controls to insure that grantee contracts are awarded in an equitable and economic manner. (See p. 22.)

## CHAPTER 1

### INTRODUCTION

Of the several programs established to carry out the purpose of the Urban Mass Transportation Act of 1964, as amended (49 U.S.C. 1601), the capital facilities grant program is the largest. The Urban Mass Transportation Administration (UMTA), Department of Transportation, administers this program and makes grants to State and local public bodies to enable them to acquire and improve existing transit systems or to build new transit systems in urban areas. Until July 1, 1973, maximum Federal assistance under the capital grant program was limited to two-thirds of the net project cost; i.e., the costs which "cannot be reasonably financed from revenues." UMTA funds capital grants approved on or after July 1, 1973, at 80 percent of net project costs. The remainder of funds needed must be provided from non-Federal sources.

At the request of former Representative Ella Grasso (see app. I), we have reviewed the awarding of a contract amendment, involving capital facility grant funds from UMTA, under which the State of Connecticut purchased 100 new railroad cars from the General Electric Company (GE) for use on the New Haven Railroad.

#### THE NEW HAVEN RAILROAD

Since before 1900 the New Haven Railroad has provided passenger service to residents along a 70-mile corridor from New Haven, Connecticut, to New York City. The main line consists of four tracks from Grand Central Station in New York City to New Haven with branch lines to Waterbury, Danbury, and New Canaan, Connecticut. Except for the branch lines to Waterbury and Danbury the system is electrified. The Railroad generates a considerable amount of its own electricity for operating certain passenger trains at its Cos Cob, Connecticut, generating plant.

In 1954 the Railroad added 100 (now 95) self-propelled electric cars to its rolling stock. The cars at that time consisted of 93 self-propelled electric cars constructed between 1922 and 1929 and 132 standard coaches constructed between 1929 and 1939. In 1961 after years of deficit operations, the Railroad went bankrupt. The financial situation of the Railroad continued to deteriorate, and by February 1965 the court-appointed trustees of the Railroad had made plans to sharply curtail passenger service.



Because of its vital link in the transportation system of Metropolitan New York, the Governors of Connecticut and New York, working through the Tri-State Transportation Commission in early 1965, sought Federal assistance from UMTA to preserve the New Haven commuter service. In response UMTA awarded a demonstration grant 1/ to the Tri-State Transportation Commission to develop the means for long-term improvement of railroad commuter service.

As a result of studies--undertaken between 1965 and 1968 under this grant--on financial, legal, and technical strategies for long-term continuance and improvement of railroad commuter service, the Connecticut Department of Transportation (CDOT) and the Metropolitan Transit Authority (MTA) of New York in 1970 entered into an operating agreement with the Railroad. This agreement provided for CDOT and MTA to buy or lease the right-of-way and some of the Railroad's rolling stock and to pay the Railroad an annual fee for operating the trains. Under the agreement CDOT and MTA (1) controlled the policy decisions for operating the passenger service, (2) were responsible for providing railroad facilities and equipment, and (3) provided funds to cover any operating deficits.

Another outgrowth of the demonstration grant was the formulation in 1967 of an UMTA assisted capital improvement program for rehabilitating the New Haven commuter service. This improvement program called for (1) purchasing up to 144 new, self-propelled electric passenger cars, (2) rehabilitating the self-propelled electric cars purchased in 1954, (3) providing new service and maintenance facilities, (4) modernizing stations and signals, (5) renovating the electric system, and (6) improving the right-of-way.

#### MTA AND CDOT PURCHASE OF NEW RAILCARS

In October 1970 after advertising and receiving bids from two companies, MTA and CDOT awarded identical contracts to GE, the low bidder, for a total of 144 electric-powered railcars--72 cars per contract. The total price for cars of each contract was \$29,048,976, or about \$403,500 per car. UMTA made separate capital grants to CDOT and MTA to assist in procuring these new cars and in the other aspects of the capital improvement program.

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1/ This grant was awarded under UMTA's demonstration project program. Allowable grants under this program include the demonstration of techniques and methods for improving mass transportation service. Federal funds may cover the total cost of such a project.

The first cars under these contracts were delivered for revenue service in April 1973. The last cars were delivered in July 1974.

In the fall of 1973 after the Railroad had completed some emergency rehabilitation work on its 1954 vintage cars and after bids had been obtained for additional rehabilitation, CDOT and MTA decided to purchase 100 new cars rather than to continue rehabilitating the old cars. In February 1974 CDOT formally requested UMTA funds and approval for purchasing the 100 additional new cars on a sole-source basis from GE by amending CDOT's existing contract.

In May 1974 UMTA's contract review board approved the contract amendment in the amount of \$63,900,000 for 100 cars, and CDOT and GE signed the amendment in June 1974. The additional new cars were funded primarily by a \$49.6 million UMTA grant amendment in June 1974. CDOT provided the remainder of the cost, with half of the funds coming from State of Connecticut bond revenues and the other half from MTA. In exchange for sharing the local costs, MTA entered into an agreement with CDOT under which MTA will have use of half the new cars during their useful life.

#### FEDERAL FUNDS FOR THE NEW HAVEN RAILROAD

Since 1965, when the Governors of Connecticut and New York first sought Federal assistance, a total of \$119.1 million in Federal grants have been approved for various purposes. These grants, provided under UMTA's demonstration and capital facilities grant programs, are summarized below.

<u>Date of grant approval</u>	<u>Purpose</u>	<u>Amount by grantee</u>			<u>Total</u>
		<u>MTA</u>	<u>CDOT</u>	<u>Tri-State Transportation Commission</u>	
(millions)					
June 1965	Demonstration grant to develop long-term continuance and improvement of railroad commuter service	\$ -	\$ -	\$3.0	\$ 3.0
Dec. 1967	Capital grants to purchase 144 new electric cars (72 each by MTA and CDOT) and to renovate the railroad's electric system, right-of-way, and stations	12.4	16.0	-	28.4
Oct. 1970	December 1967 grant amended to provide funds originally requested	5.9	5.8	-	11.7
Feb. 1972	Capital grant to rehabilitate old railcars and to complete the system renovation	-	15.1	-	15.1
Sept. 1972	February 1972 grant amended to provide total funds originally anticipated	-	11.4	-	11.4
June 1974	February 1972 grant amended to limit rehabilitation of old cars and to purchase 100 new cars	-	49.6	-	49.6
Total		<u>\$18.3</u>	<u>\$97.9</u>	<u>\$3.0</u>	<u>\$119.2</u>

## SCOPE OF REVIEW

We reviewed the awarding of the contract amendment under which CDOT purchased 100 additional new railroad cars from GE. We reviewed the procedures used in awarding the contract amendment, the terms of the payment schedule to GE, and the conditions of the contract amendment with GE.

We made our review at UMTA headquarters in Washington, D.C.; CDOT in Hartford, Connecticut; MTA in New York City; GE in Philadelphia, Pennsylvania; and Louis T. Klauder and Associates (consulting engineers for CDOT and MTA) in Philadelphia, Pennsylvania. We reviewed the applicable legislation, UMTA policies and procedures, and the project records and reports relating to the Federal grants at UMTA headquarters and CDOT.

We interviewed UMTA, Connecticut, and New York officials involved in administering this project, as well as GE and Klauder and Associates officials familiar with the project.

We have included pertinent comments in the report obtained from the agency, grantee, and contractor. Written comments received from the Department of Transportation have been included as appendix II.

## CHAPTER 2

### PROCEDURES USED IN AWARDING A CONTRACT TO GE AND CONDITIONS OF THAT CONTRACT

The purchase of the 100 railcars was accomplished by amending the original contract between CDOT and GE without obtaining competitive proposals. Timing appears to have played an important role in the decisions leading up to the contract amendment approval.

#### RATIONALE FOR PURCHASING NEW CARS RATHER THAN REHABILITATING OLD CARS

Plans for major rehabilitation of the cars purchased in 1954 were developed in 1967 under the demonstration grant for developing long-term improvement of railroad commuter service. MTA, which owned 47 cars, and CDOT, which owned the other 48 cars, did not undertake a specific program of rehabilitation until 1971. At that time only one potential contractor responded to a bid solicitation, and its quoted price of \$172,000 per car was considered too high by MTA and CDOT. However, the Railroad began selected rehabilitation early in 1972 for MTA and CDOT to keep the cars in service, because a Federal Railroad Administration safety inspector had stated that the cars were not safe and were very close to being taken out of service.

In January 1974 CDOT established a price of \$231,000 per car to rehabilitate the 95 old cars. This price, adjusted for price escalation, was based on a quotation received in August 1973 from a potential contractor. MTA and CDOT officials held subsequent discussions and considered buying new cars rather than continuing the rehabilitation program. According to MTA and CDOT officials, GE was verbally asked to quote a price for 100 cars, and in November 1973 GE quoted a price of \$1,278,000 for a married pair of cars. 1/

On the basis of the above prices and the projected life expectancies of 10 years for rehabilitated cars and 30 years for new cars, CDOT estimated that the annual amortization cost would be \$23,100 and \$21,825, respectively.

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1/ The cars are purchased in married pairs because they share certain car components such as auxiliary power supply components.

Concluding that amortization costs would be almost equal and that new cars would be more adaptable to scheduling requirements, CDOT decided to purchase new cars, although the initial capital investment was about \$41 million greater than the cost of rehabilitating the old cars. In December 1973 CDOT sent GE a letter of intent to buy 50 pairs of cars at the quoted price.

In February 1974 CDOT applied to UMTA to amend its February 1972 grant to delete the unused funds for the uncompleted rehabilitation work and in its place requested Federal funds to purchase 100 new cars. In the grant application CDOT maintained that rehabilitating the old cars was no longer desirable. CDOT pointed out that the cost of the rehabilitation program was conservatively estimated at \$231,000 per car and that there could be many unknown factors which could increase the cost but that such factors could not be determined until the cars were disassembled.

CDOT also presented the following justification in its application for scrapping the planned renovation of the old cars.

- The capital improvement program included renovating the Railroad's electric system and modernizing the signal system, both of which were scheduled for completion by the end of 1975. The electric propulsion and control equipment of the old cars would have had to be modified and cab signal systems added before they could operate under the improved electric system. The new GE cars would have the capability to operate under either system.
- Because the old cars received inadequate maintenance during their 20 years of service, a complete renovation of the interiors and exteriors and an overhaul of passenger environment equipment would have been necessary.
- Any practical rehabilitation program would have required numerous old cars to be out of service at any one time, which would have created a severe scheduling problem on commuter service.
- If the old cars had been rehabilitated, maintaining them would have continued to be costly; their service dependability would not have been acceptable compared with that of the new cars; they would have been slower than the new cars, restricting the implementation of faster schedules.

CDOT requested UMTA's approval to purchase the cars on a sole-source basis from GE, as a follow-on to its previous contract with GE for 72 cars.

FACTORS CONSIDERED FOR  
SOLE-SOURCE PROCUREMENT

In its request to UMTA for approval to amend the GE contract, CDOT stated that a sole-source procurement from GE was "mandated in the interest of product quality and standardization, early delivery and avoidance of a costly repetition of the debugging experience on the 144 cars." CDOT pointed out that there were problems with the original cars from GE, which required major retrofit programs; CDOT believed that GE had profited from its experience.

An MTA official told us that the problems experienced with the original cars from GE were not extraordinary and were comparable to those experienced by any car manufacturer building a new car. MTA and GE officials told us that the problems had been identified and had been or were being corrected.

CDOT incorporated in its February 1974 application a January 1974 letter from its engineering consulting firm recommending a sole-source procurement from GE. The consulting firm was under contract to CDOT and MTA as supervising engineers to oversee GE's construction of the 144 cars.

The consultant's recommendations were based on the premise that only GE had experience in building the type car required, and if any other manufacturer were awarded the contract:

- Considerable additional time would be required for such factors as engineering, tooling-up, manufacturing, and debugging the cars.
- An inferior product could result if that manufacturer compromised product quality in order to compete against GE's experience in manufacturing the cars.
- Separate inventories of spare parts could be required if the manufacturer selected different major suppliers.

In addition the consultant's letter stated that other potential manufacturers would not be interested because of existing commitments. A representative of the consulting

firm told us that because of the firm's position in the rail-car industry, it had knowledge of the current and future production schedules and the capacities of the other domestic car builders; therefore, specific inquiry of these car builders to determine their interest in bidding was not necessary. He told us also that his firm, however, had contacted two potential Canadian firms and that both had indicated that they would not be in a position to bid. The consultant also reviewed GE's quoted price of \$1,278,000 per pair of cars and concluded it was reasonable and contained no erroneous or improper costs.

#### UMTA contract approval process

Under UMTA directives, which conform with the intent of Federal administrative requirements for grants to States as set forth in General Services Administration (GSA) Federal Management Circular 74-7 (formerly Office of Management and Budget Circular A-102), grantees are responsible for both selecting the contractor (through either competitive bidding or negotiation arrangements) and evaluating the proposals, including technical evaluation and cost-price analysis, audit, and total administration of the contract.

UMTA's contract review board makes preaward reviews of proposed contracts to be awarded on a sole-source basis when the contract amount exceeds \$5,000. The review board consists of the following three UMTA officials: (1) the Associate Administrator for Administration, (2) the Chief Counsel, and (3) the Chief of Contract Analysis. In making such reviews the board is to insure that

- correct procedures are followed in developing the proposed contract and that they are properly documented,
- the justification for sole-source procurement is adequate and consistent with UMTA policy, and
- the price is reasonable.

When it is appropriate, the board can prescribe alternative procurement actions.

UMTA directives for third-party contracts require formal advertising and free, open, and unrestricted competitive bidding; however, procurements may be negotiated under certain circumstances, including situations where

- the public need will not permit the delay incident to advertising,



--the material to be procured is available from only one firm, and

--the purchases are for technical equipment requiring standardization of parts with existing equipment.

Primarily on the basis of one of these exceptions--that public need will not permit the delay incident to advertising--UMTA approved a negotiated procurement of the 100 railcars from GE.

Basis for UMTA approval of  
sole-source procurement from GE

In May 1974 the board reviewed and approved the proposed GE contract amendment for sole-source procurement of the 100 cars. The board did not document what factors in CDOT's justification it believed were sufficient to warrant a sole-source procurement. Two board members told us that in the board's opinion, a sole-source procurement was justified, primarily on the basis of the critical time factor relative to the closing of the Cos Cob electric powerplant and to the completion of the electric system renovation scheduled for the end of 1975. The existing electric system is operated by using 25-cycle alternating current supplied from the Cos Cob powerplant, which is obsolete and cannot comply with air quality standards prescribed by the Environmental Protection Agency. The older, self-propelled cars being replaced are designed to operate solely on 25-cycle power. The electric modernization program provides for converting the electric system to 60-cycle power and will permit closing the Cos Cob plant.

A board member said that the board had approved the sole-source procurement primarily on the basis of the engineering consultant's belief that if any manufacturer other than GE were awarded the contract, its lack of experience could extend the delivery date by several years. The board member stated that under the proposed GE contract amendment, GE would deliver the cars within the general time constraints of the planned powerplant's closing. Under the contract amendment, delivery of the 100 cars was scheduled to begin in July 1975 and to be finished by March 1976. A representative of the consulting firm and GE told us that the first pair of cars was delivered in May 1975 and that it appeared that the remainder of the cars would be delivered correspondingly early.

The board members told us that other factors used in justifying sole-source procurement, such as product standardization and lack of interested manufacturers, would not

have been sufficient in themselves to justify a negotiated procurement from GE.

#### Verification of GE's price

Under UMTA directives grantees are responsible for negotiating the terms of third-party contracts. Although the directives provide for furnishing the basis for the cost or price negotiated, they do not specifically provide the grantee guidance on particular negotiating policies and techniques relating to such matters as cost or price analysis or on determination of profits. CDOT used its engineering consulting firm which was overseeing the manufacturing of the previous 144 railcars to analyze GE's price proposal for the 100 additional cars. An official of the engineering firm said that the firm was orally requested by CDOT to evaluate GE's proposal and to advise CDOT whether the price of \$1,278,000 per pair of cars was fair.

An MTA official said that before GE's firm offer in November 1973 to provide 50 pairs of cars at \$1,278,000 per pair, MTA officials had obtained a verbal quote from GE in September 1973 of \$990,000 per pair of cars which did not provide for warranty work but did provide for relief from penalties for late delivery and overweight cars. He also said that the November 1973 quote was much higher primarily because (1) there would be no relief from penalties, (2) the material prices had increased substantially, and (3) the price included an estimated cost for warranty work. In December 1973 GE gave oral presentations to representatives of MTA, CDOT, the consulting firm, and UMTA to explain the breakdown of their costs. In January 1974 the consulting firm submitted its evaluation of GE's price.

By letter dated January 17, 1974, the consulting firm told CDOT that it had analyzed a breakdown of GE's costs, including reviewing copies of GE's vendors' quotations which the consultant concluded substantiated the figures used in compiling material costs. The letter stated that:

"\* \* \* in light of our review of General Electric's comprehensive presentations of cost build-up and our own study of the vendor quotations used in compiling material costs, we can find no evidence of erroneous or improper cost development, and we find the final figure to be justifiable and, in the light of present day material procurement and pricing problems, reasonable."

The firm further stated that its analyses of the vendors' quotations substantiated GE claims that the material cost per car alone exceeded the 1970 unit selling price for the original 144 cars by \$16,000 and that:

"\* \* \* Starting with this material cost as a base and adding the necessary engineering, manufacturing expenses, field support, and allowances for profit (10 percent) and administrative expenses, we again find General Electric's price justifiable."

Officials of the consulting firm told us that no attempt was made to negotiate a price reduction because they considered the price to be reasonable, and, because the cars were required to be identical to the original 144 cars, they could not alter the specifications in exchange for a lower price.

It appears that GE submitted limited cost or pricing data in support of its proposal and a representative of the consulting firm made a limited review of cost records maintained at the GE plant. For example, the development of overhead rates had not been explained and supported with related historical costs and future cost projections; and materials costs, except for car shells and material purchased from within GE, did not establish how GE had selected suppliers and had determined that suppliers' prices were reasonable. The consulting firm representative completed his analysis of GE's cost buildup by reviewing cost records at the GE plant for 1 day. It appears, therefore, that the consulting firm made only limited verification of the accuracy, completeness, and currency of cost data GE submitted. UMTA and CDOT's only support of the reasonableness of the GE price was the letter of January 17, 1974, from the consulting firm. That letter revealed very little about the cost or pricing data submitted or the scope of the consulting firm's analysis of this data.

The consulting firm representative told us that railcar manufacturers have traditionally considered cost and proprietary information confidential and have not revealed it to prospective buyers; therefore, his firm's January 17, 1974, letter to CDOT did not reveal much detail because his firm respected GE's request to consider its cost data confidential. He told us also that compared to other industries, which have experienced long-term Government involvement, the cost data provided by GE and his firm's analysis of it may appear limited but, in relation to the standards of the railcar industry, the cost data provided by GE was the most comprehensive ever offered by a contractor and his firm's analysis of it was correspondingly extensive.

The information GE submitted in support of its proposal price appears to have satisfied the broad intent of UMTA directives to furnish the basis for the cost or price negotiated. In contrast to this standard the Federal Procurement Regulations, 1/ in sole-source procurements involving amounts over \$100,000, require submitting detailed cost and pricing data certified by the contractor as to its accuracy, completeness, and currency. We believe the interests of the Federal Government would have been better protected if the grantee had been required to follow more detailed procedures along the lines of those required by the Federal Procurement Regulations.

#### CONTRACT PROVISIONS FOR ACCELERATED PAYMENTS

UMTA directives provide that grantee payments to third-party contractors shall, whenever practicable, be established on a regular schedule based on a planned forecast of work to be completed. The directives thus allow grantees to pay third-party contractors commensurately with the work performed but allow another type of payment schedule, not necessarily related to performance, to be used if the circumstances should so require.

Payments made to a contractor, based on the extent of work actually performed under a contract, are generally referred to as "progress payments," while payments made before performance under a contract and which are not related to the extent of performance are generally referred to as "advance payments." The Federal Procurement Regulations also distinguish between progress and advance payments and generally require that contractors receiving advance payments provide additional security to the Government in the form of liens, payment bonds, or other suitable security.

According to CDOT, MTA, and UMTA officials, GE's proposal of \$1,278,000 per pair of cars was conditional upon CDOT, MTA, and UMTA's accepting a payment schedule under which GE would receive 70 percent of the contract price before production began and an additional 25 percent of the price upon acceptance of the first pair of cars. The payment schedule also provided that title would not pass to CDOT until shipment of the completed railcars, a point at which 85 percent of the

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1/ Neither UMTA's grant agreement with CDOT nor the Urban Mass Transportation Act of 1964, as amended, contain an express requirement that the terms and conditions of the Federal Procurement Regulations be followed.

contract price will have been paid to GE. CDOT and MTA officials said GE had told them that such a payment schedule would eliminate the need for GE to borrow funds to finance the manufacture of the additional 100 cars. According to these officials, GE told them that the \$1,278,000 price per pair of cars would otherwise be \$70,000 greater, or \$3.5 million more for the 100 cars.

The benefits to all parties in accepting the proposed accelerated payment schedule were not documented in the contract amendment or provided elsewhere to UMTA. In contrast in the original contract for 144 cars, a schedule of progress payments (as shown below) was proposed in exchange for a specified reduction in price. Otherwise, payments under the original contract would have been made 45 days after each car had passed inspections and tests, without any progress payments. The progress payment schedule was accepted in exchange for a 3 percent price reduction under the original contract.

The payment schedule for the 100 cars enabled GE to obtain funds at much earlier stages than the payment schedule for the original 144 cars would have done. Under the contract for the 144 cars, payments were to be made as follows:

- 5 percent of total contract price for all cars on approval of engineering and production schedules.
- 25 percent of price per pair of cars on receipt of shells at assembly plant.
- 25 percent of price per pair of cars 60 days after receipt of shells at assembly plant.
- 20 percent of price per pair of cars upon shipment from plant.
- 15 percent of price per pair of cars upon completion of testing.
- Remainder of price per pair of cars upon acceptance.

Under the contract amendment for the 100 additional cars, payments were to be made as follows:

- 30 percent of total contract price on placement of structural steel orders.
- 25 percent of total contract price on placement of equipment orders.

- 15 percent of total contract price on approval of production assembly schedule.
- 15 percent of total contract price on shipment of first pair of cars.
- 10 percent of total contract price on acceptance of first pair of cars.
- Remainder of total contract price 45 days after acceptance of last pair of cars.

The amended UMTA grant provides for payments of the Federal share to CDOT in a corresponding manner. By August 9, 1974, UMTA had paid \$29.7 million to CDOT as the Federal share of CDOT's payments of \$42.8 million to GE for completion of the first three payment events. The consulting firm certified to CDOT that the first three phases of the project had been completed; i.e., placement of structural steel orders, placement of major equipment orders, and approval of production schedules. The fourth payment event was scheduled to occur in July 1975. GE informed us in June 1975 that the first pair of cars was delivered in May 1975 and that payment was scheduled to occur in June 1975.

By June 1974, when GE had received \$29.1 million of the \$42.8 million, it had incurred costs of only \$2.5 million. By September 1974 GE had received all of the \$42.8 million and had incurred contract costs of only \$2.9 million. Contract costs incurred by GE through December 1974 had increased to \$4.5 million. GE informed us in June 1975 that contract costs incurred through May 1975 amounted to \$25.7 million.

On the basis of the above analysis, we believe that the payments to GE are in the nature of advance payments because they were made before any substantial performance under the contract. Considering that the reason given for the accelerated payment terms was to enable GE to finance the manufacturer of the additional 100 cars without borrowing, it would seem that this objective could have been achieved with a payment schedule that called for payments shortly before costs were incurred rather than on the accomplishment of certain stages. UMTA's records do not contain any evidence as to whether GE would have built the cars at the quoted price with a payment schedule that would have provided funds to GE under such a payment schedule.

According to UMTA, the payment schedule was justified under the circumstances. UMTA's contract review board approved the contract with the accelerated payment terms in

May 1974. UMTA officials said that at the time of the approval they realized that the payment schedule could result in advances to GE, but because GE had held the quotation firm longer than customary, they believed that any further delays in approving the contract might have resulted in GE's withdrawing its November 1973 offer.

UMTA officials also stated that because they realized that the payment schedule could result in advances to GE, they required that the contract between CDOT and GE contain certain safeguards against the possibility of excess profits resulting from the use of such advances. These safeguards required GE

- to limit its profit to 12 percent of the \$63.9 million price for the 100 cars (\$7.7 million),
- to refund any contract payments received which exceed the sum of the actual contract costs incurred and the \$7.7 million, and
- in determining any refund (1) to compute an interest adjustment for the use of advance funds at 10 percent simple annual interest on the amount by which advances exceed costs and (2) to reduce the actual contract costs by that adjustment.

UMTA also required provisions in the contract to

- exclude certain startup costs applicable to the manufacturing of the original 144 cars from the costs applicable to the 100 additional cars and
- provide for the right to final and binding audit by the Federal Government to determine allowable cost and profit at time of contract completion.

UMTA officials stated that GE objected to these requirements and to the amount of time it was taking to approve the contract. Recognizing the probable increase in costs from the time GE made its offer in November 1973 to June 1974 when the contract was signed, UMTA approved a contract including the foregoing provisions, except that GE was allowed to reduce the amount computed for the 10 percent interest adjustment by an amount not to exceed \$1,332,000. The net effect of this provision allowed GE to have interest-free use of the advances for the first \$1,332,000 of interest on the advances.

In addition, because the final audit of the contract would be conducted at the time of contract completion rather than after the warranty period (as desired by GE), UMTA approved a provision in the contract amendment to allow GE to add \$4,392,800 to allowable contract cost for estimated costs of warranty work that might be done after delivery of the cars. The consulting firm told us that one of the price factors GE included in its \$1,278,000 per pair quote was an allowance for warranty work of \$43,928 per car.

However, UMTA did not require additional contractual provisions, similar to those required by the Federal Procurement Regulations for advance payments, to protect the Government and the grantee should the contract not be completed. For example, the Federal Procurement Regulations would require liens in favor of the Government on excess advance funds and on material under contract. Although UMTA directives do not deal with such safeguard provisions where advance payments are made, we believe that business prudence would have dictated including protective clauses along the lines of those required by the Federal Government in its contracts.

Possible financial effect of  
the accelerated payment terms

We estimated the possible financial effect to the Federal Government as a result of the accelerated payment terms. On the basis of UMTA and CDOT disbursement data and GE cost data available at the time of our review, GE would have interest-free use of the funds advanced before actual needs if its cost and profit equaled or exceeded the contract price. The Federal Government will incur about \$2.1 million in additional interest costs in providing the Federal share of the advance funds. We did not determine the financial effect of the accelerated payments on the States of Connecticut and New York.

In 1974 when the advances were made to GE, the Federal Government's interest costs averaged about 8.5 percent simple annual interest. Applying this rate to GE's monthly balances of amounts by which advances exceeded costs indicates that the Government had incurred about \$1.2 million of additional interest cost as of December 31, 1974.

On the basis of a cost forecast through contract completion prepared by GE as of December 31, 1974, the balances of the first three contract advances were expected to be liquidated by about July 1975. However, the next two contract payments will be made to GE upon respective delivery



and CDOT's subsequent acceptance of the first pair of cars, which again will put GE in the position of holding contract funds which exceed contract costs. All of these anticipated advances--the unliquidated balance of payments made in 1974 and payments projected for 1975--were expected to be liquidated by December 1975. The total interest cost to the Government over the projected period of January through December 1975 approximates an additional \$900,000.

Under the contract provisions required by UMTA, refunds could be made and the Federal share of such refunds would reduce the Government's estimated interest costs of providing the advance payments to GE. The extent of refund, if any, under the contract is contingent upon total net allowable costs plus the profits not exceeding the contract price of \$63.9 million. Allowable costs, however, cannot be computed until all advances have been liquidated since costs are incurred during the period of manufacturing the cars. According to a cost forecast GE provided us, GE's total costs will exceed the total maximum contract price of \$63.9 million. If this forecast holds true, no refunds will be made.

#### CONCLUSIONS

Although UMTA's third-party contracting directives conform with the intent of Federal administrative requirements for grants to States, these directives do not provide enough specific criteria regarding procurement methods, especially negotiations of sole-source procurement and progress and advance payments. As a result, the contract amendment UMTA approved reflected certain weaknesses in the contracting procedures.

- The amendment included a payment schedule which provided funds to the manufacturer considerably in excess of costs incurred at designated payment dates.
- Advance payments were made without any contractual provisions to protect the Government and the grantee, should the contract not be completed.
- UMTA approved the awarding of the contract on a sole-source basis, without adequate assurance that the price proposed was fair and reasonable, because (1) GE had not submitted adequate cost or pricing data in support of its proposed price and (2) an adequate analysis had not been made of the data available as to its accuracy, completeness, and currency.

The directives should be expanded to strengthen UMTA's procurement procedures and to provide better protection for the interests of the Federal Government. The Federal Procurement Regulations contain specific criteria in these areas of contracting and could serve as a pattern for expanding UMTA's third-party contracting directives.

Furthermore, written documentation setting forth the basis for any special conditions and benefits provided by all third-party contracts should be required from grantees. UMTA should also document what factors justified the approval of sole-source procurements and any special contract conditions setting forth how these conditions (1) meet the UMTA capital grant program objectives and (2) are in the best interest of the Federal Government.

#### AGENCY COMMENTS AND OUR EVALUATION

In a June 26, 1975, letter (see app. II), the Department of Transportation stated that while it agreed with certain specifics of our report, it disagreed with our conclusions that UMTA approved a contract amendment that did not conform with sound contracting procedures.

The Department stated that the payment schedule, which allowed GE to receive funds in excess of those required to build the cars without borrowing, was negotiated in exchange for a \$4.5 million reduction in the contract price. According to the Department, our statement that GE could have interest-free use of the contract funds advanced, before actual needs, while the Federal Government will incur about \$2.1 million in additional costs, correctly describes the worst possible situation--when the contractor exceeds his estimated costs. The Department stated that the best case would be the \$4.5 million reduction in the contract price plus the 10 percent interest adjustment on the advanced funds which the Department computed would amount to \$1,757,000. Thus, the Department points out there could be a net savings to the grantee of \$6,257,000 (\$4,500,000 plus \$1,757,000).

Contract records made available to us contained no evidence that the price was negotiated in exchange for the payment schedule. As pointed out on page 14, GE claimed that its price offer would have been greater by an estimated \$3.5 million (later estimated to be \$4.5 million) if CDOT and MTA had not accepted the proposed payment schedule. This claimed reduction was to have reduced GE's overhead costs because the accelerated payments would save GE the cost of borrowing. However, because (1) the consulting

firm did not do a detailed analysis of GE's overhead cost data, and (2) the benefits to all parties in accepting the accelerated payment terms were not documented, UMTA did not receive sufficient information as to how much the payment schedule actually reduced the contract price.

As discussed on page 18, we have recognized the possibility of an interest adjustment resulting in a possible refund which would have the effect of reducing the Government's estimated interest costs of providing the advance payment to GE. However, the interest adjustment was a conditional reduction to the contract price and refundable only if the allowable costs and profit were less than the contract price of \$63.9 million.

In both the case presented by the Department of Transportation and the case presented in our report, the \$3.5 to \$4.5 million savings resulting from GE not having to borrow funds was considered. Our computation of the \$2.1 million additional cost to the Government applies only to the Federal share of the excess funds provided to GE over the funds needed to manufacture the railcars without borrowing. Any comparison of the best case and the worst case should therefore be made between the cost to the Government of borrowing, which would be the same in either case, and (1) an interest-free loan if GE's costs exceed the contract price less the 12 percent profit, or (2) a refund, computed by UMTA to be as much as \$1.8 million, if the costs and profits are less than the contract price.

The Department stated, however, that in the future, UMTA will limit grant payments to those amounts needed by the grantee and the contractor to meet current and near-term disbursements.

The Department did not agree that there were no provisions in the contract to protect the Government in case the contract is not completed. It pointed out that the contract itself provided the safeguard and that if the contractor chose to breach the contract through bankruptcy or otherwise, the grantee had recourse to the courts. The Department recognized that additional assurances such as those used under the Federal Procurement Regulations could have been used. However, because of the claimed lower contract price for the accelerated payment schedule, GE's previous performance and reputation, and the increased cost of obtaining securities, UMTA considered it in the best interests of the Government and of the grantee to forego the additional protection.

In view of the considerable amount of the advance payments under the contract, the fact that the contractor retained title until shipment of the completed railcars, and the potential of costly and prolonged litigation to recover the Government's investment should the contractor breach the contract, we believe that additional contractual provisions, such as, liens in favor of the Government on excess advance funds and on material under contract, should have been used to protect the interests of the Federal Government and the grantee. Such provisions would have provided protection similar to that provided under the Federal Procurement Regulations.

The Department stated that the assurances provided by the grantee on the reasonableness of price and the additional requirements UMTA placed on the contractor provided what good procurement practices would dictate. The Department further stated that the prime purpose of the price and cost analysis was to insure that the price was fair and reasonable and, therefore, the contractor was not likely to make a windfall profit. The Department stated that with the price and cost analysis and the profit limitation clause in the contract, with the right to audit, there was very little additional assurance that UMTA could obtain.

We believe that the profit limitation and the right to audit represented positive steps by UMTA toward protecting the Government and the grantee. However, as pointed out on page 12, the analysis made by the consulting firm of GE's cost data was limited. We believe that a profit limitation, when based on a percentage of price which was not analyzed completely, can not adequately guarantee against a windfall profit. We believe that better protection would have been provided with a complete cost and price analysis, a less liberal payment schedule, and greater security required in the contract.

The Department stated that it recognizes the difference in procedures used by the Federal Government under Federal Procurement Regulations and the procedures used by grantees under various State laws and regulations. However, the Department's policy is to allow grantees to use their own procurement procedures so long as they meet certain minimum requirements. The Department pointed out that GSA's Federal Management Circular 74-7, Attachment O, establishes the procurement standards for grantees and provides that "No additional requirements shall be imposed by the Federal agencies upon the grantees unless specifically required by Federal law or Executive orders."

We recognize that to some extent the GSA Management Circular restricts Federal agencies from imposing requirements on grantees in carrying out grant objectives. We believe, however, that the present circular is broad enough to have permitted UMTA to require the grantee to secure a more complete cost and price analysis from the contractor, to adhere to a payment schedule commensurate with the work performed by the contractor, and to insure that adequate safeguard provisions were included in the contract amendment to protect the interests of the Federal Government and the grantee.

Although some differences in opinion exist as to whether the provisions of this contract adequately protect the interests of the Federal Government, our major concern is that the standards for grantee procurement be strengthened to insure that, in the future, the Federal Government's interests are adequately protected. In this light we noted that on July 9, 1975, the Transportation Department's Assistant Secretary for Administration notified the various agencies in the Department, including UMTA, that GSA had established an Interagency Study Group to review the provisions of its Federal Management Circular 74-7, Attachment O, and of the appointment of a Department representative to the group. In this announcement, the Assistant Secretary stated that during the past 2 years, the Department had made several requests to GSA to revise the grantee procurement standards in Attachment O. The Department's objection to Attachment O is that it does not provide Federal agencies with adequate controls to insure that grantee contracts are awarded in an equitable and economic manner.

We agree with this opinion and therefore believe that the Department's representative on the GSA Interagency Study Group should work toward developing and adopting grantee procurement standards which reflect the following recommendations.

#### RECOMMENDATIONS

We recommend that the Secretary of Transportation (1) direct his representative on the GSA Interagency Study Group to work toward developing and adopting procurement standards which provide greater protection to the Federal Government, and (2) require UMTA to develop:

--more specific third-party contracting procedures for use by grantees, possibly patterned after the Federal Procurement Regulations, to insure that the awarding of contracts involving negotiated sole-source procurements are conducted and documented in a manner permitting UMTA to determine whether the price negotiated is fair and reasonable and

--third-party contracting procedures for use by grantees, setting forth the conditions and limitations in providing payments with grant funds which adhere to the principle of minimizing the time elapsed between the transfer of funds from the U.S. Treasury and the final use made of those funds.

We also recommend that the Secretary require UMTA to develop requirements for UMTA and grantee documentation of the justification for sole-source procurements and all special contract conditions and payment provisions in third-party contracts.

APPENDIX I

ELLA T. GRASSO  
SIXTH DISTRICT, CONNECTICUT

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APPENDIX I

COMMITTEES  
EDUCATION AND LABOR  
VETERANS' AFFAIRS

**Congress of the United States**  
**House of Representatives**  
**Washington, D.C. 20515**

October 25, 1974

The Honorable Elmer B. Staats  
Comptroller General  
U.S. General Accounting Office  
Washington, D.C. 20548

Dear Mr. Staats:

It has come to my attention that contracts involving funds from the Urban Mass Transportation Administration (UMTA), under which the States of Connecticut and New York purchased 100 new railroad cars for the New Haven Railroad, include some procedures that I believe require investigation by your office.

The 100 rail cars were purchased from the General Electric Company. The contract terms were negotiated by the State of Connecticut, acting for New York and UMTA. The questions I have concern terms of the payment schedule and the procedure used in the awarding of the contract.

Eighty percent federal funds are involved, \$51.1 million, and 10 percent funds from each state. The total contract is for \$63.9 million.

According to documents available in Connecticut, the agreement with GE calls for a pre-payment schedule that to date has allowed 66 percent of the funds to be paid although no rail cars have been delivered. Up to 95 percent of the contract will have been paid after delivery to the states of only a single pair of rail cars.

The contract, also, was handled without any public evidence of competitive bidding, despite the fact that the previous contract with GE has yielded rail cars that have a very poor performance record.

Because federal funds are involved, I believe it is proper to request that your office begin an investigation into the procedures used in the contract, the pre-payment schedule and the conditions of the agreement with General Electric.

Cordially,

*Ella Grasso*  
ELLA GRASSO  
Member of Congress

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ASSISTANT SECRETARY  
FOR ADMINISTRATION

OFFICE OF THE SECRETARY OF TRANSPORTATION

WASHINGTON, D.C. 20590

June 26, 1975

Mr. Henry Eschwege  
Director  
Resources and Economic Development  
Division  
U. S. General Accounting Office  
Washington, D. C. 20548

Dear Mr. Eschwege:

This is in response to your letter dated May 20, 1975, requesting our comments on the General Accounting Office's (GAO) draft report on the procurement of rail passenger cars for the New Haven Railroad. In summary, the reply points out that we agree with certain specifics of the report, but we do not agree with the conclusion that those actions were not in conformance with sound contracting principles. As stated in your report, the Urban Mass Transportation Administration's (UMTA) directives conform to Federal administrative requirements for grants. The General Services Administration's (GSA) Management Circular 74-7 restricts us in that it states that no additional requirements shall be imposed by the Federal agencies upon the grantees unless specifically required by Federal law or Executive Orders. UMTA believes that in this case Government funds were adequately protected because under no circumstances can the contractor make more than a 12 percent profit on this contract and indications are that he is likely to suffer a loss.

I have enclosed two copies of the Department's reply, which expresses our position on the GAO findings and conclusions.

Sincerely,

  
William S. Heffelfinger

Enclosure  
(Two copies)



DEPARTMENT OF TRANSPORTATION REPLY  
TO  
GAO DRAFT REPORT NO. B-127449  
ON  
PROCUREMENT OF RAIL PASSENGER CARS  
FOR THE NEW HAVEN RAILROAD

Summary of GAO Findings and Recommendations

The GAO concluded that UMTA approved a contract amendment that was not in conformance with sound contracting principles. The bases for this conclusion were:

1. The payment schedule provided funds to the contractor in excess of the contractor's expenditure schedule.
2. The payments were made without contractual provisions to protect the government and the grantee if the contract was not performed.
3. The sole-source award was made without assurance to UMTA that adequate cost and pricing data had been submitted by the contractor.

The GAO recommended that UMTA develop more specific third-party contracting procedures for use by grantees. The procedures should set forth conditions and limitations in providing payments with grant funds, as well as detailed procedures on negotiation of sole-source procurements.

Summary of Department of Transportation Position

The report points out areas where the GAO feels that sound procurement procedures were not followed in concurring in a contract between a grantee and a contractor. We recognize the difference in procedures used by the Federal Government under Federal Procurement Regulations and the procedures used by grantees under various State laws and regulations. However, the Department of Transportation policy is to allow the grantee to use his own procurement procedures so long as they meet certain minimum requirements. The actions taken by the grantee were within those minimum requirements and actions taken by the Department of Transportation were authorized by the Urban Mass Transportation Act of 1964, as amended through November 26, 1974.

Position Statement

While we agree with certain specifics of the report, we do not agree with the conclusion that those actions were not in conformance with sound contracting principles, nor do we agree with the reasons for the conclusion.

Specifically, the statement that the manufacturer received funds in excess of those required to build the cars without borrowing funds is incomplete. The payment schedule submitted to UMTA for approval contained milestone payments negotiated by the grantee for which the grantee received consideration in the amount of approximately \$45,000 per car reduction in the price quoted by the contractor, or a \$4,500,000 total reduction. UMTA chose to further impose the requirement that the contractor set off against any costs he incurred, an amount equal to 10 percent simple annual interest on any funds he received in excess of his expenditures. This would not be applied if the contractor was in a loss position and applied on a sliding scale up to the point where the contractor received 12 percent profit. Thereafter, the grantee would receive a 10 percent return on the use of any funds that were excess to those incurred.

It is stated on page 17<sup>1</sup> of the report that ". . . it appears that GE could have interest free use of the funds advanced prior to actual needs, while the Federal Government will incur approximately \$2.1 million of additional interest costs in providing the Federal share of funds advanced prior to actual needs."

The above statement correctly presents the situation in only the "worst" case--when the contractor exceeds his estimated costs. The following comments explain the cost/benefit relationship between the price of the cars and the use of the advance payments.

Initial consideration to grantee for accelerated payment schedule (unaudited estimate by contractor of \$45,000.00 per car)....	\$4,500,000
*10% simple annual interest on advanced funds.....	<u>\$1,757,000</u>
NET Savings to Grantee (best case).....	\$ 6.257

\*Figures derived from GAO estimate of excess federal funds plus state funds.

<sup>1</sup> GAO note: Page number refers to page in final report.

An additional factor that was part of the total package was a 12% limitation on profit. This clause guarantees the grantee and UMTA that under no circumstances, including the use of excess funds, could the contractor realize a profit greater than 12%. This is considered reasonable profit on a fixed-price contract. UMTA attempted in this case to assure that the payments made to the contractor by the grantee were commensurate with expenditures. UMTA's initial requirement for a revised payment schedule was reviewed because the payment schedule was a consideration by the grantee for the contractor's reduction in the total price of the cars of approximately \$4,500,000.00, and the fact that he was holding to a firm quote for several months past the required period. While this was a negotiated package agreement in which the grantee received consideration for the payments in excess of expenditures, UMTA will, in the future, limit such payments to those amounts needed by the grantee and the contractor to meet current and near-term disbursements.

We do not agree that there were no contractual provisions to protect the government in case the contract was not performed. The contract, itself, provides that safeguard and if the contractor chooses to breach the contract through bankruptcy or otherwise, the grantee has recourse to the courts for a cure of the breach. However, the contractor's performance on the manufacture of 144 cars on a present order and his reputation in world-wide industry, gave the grantee and UMTA enough assurance of his responsibility when considered in the context of the total package.

It is recognized that additional assurances such as those used under Federal Procurement regulations could have been used. However, because of the considerations to the grantee for the payment schedule, it was considered in the best interests of the government and the grantee to forego the additional protection. Other security in the form of bonding suitable to the grantee, was and still is available as a contractual agreement. However, the grantee chose not to require bonding because of an additional cost estimated to be \$80,000.00. Since the additional security would have added further to a cost-oriented negotiation, it was considered in the best interest of the grantee and UMTA not to obtain additional security.

We do not agree that the assurances provided by the grantee on the reasonableness of price and the additional requirements placed on the contractor by UMTA provided anything less than good procurement practices would dictate. In a five-page report to the Connecticut Commissioner of Transportation, the

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grantee's consultant stated that the contractor ". . . presented a detailed breakdown on their price, outlining the various components contributing to the total." The consultant further stated that they ". . . were comprehensive and unprecedented in the detail of proprietary information made available to us." Based on this, the consultant made the following statement in the report:

"Regarding the second factor, we have analyzed the quoted price of \$1,278,000 per married pair and, in light of our review of General Electric's comprehensive presentations of cost build-up and our own study of the vendor quotations used in compiling material costs, we can find no evidence of erroneous or improper cost development, and we find the final figure to be justifiable and, in the light of present day material procurement and pricing problems, reasonable."

In addition, the contractor and the grantee gave UMTA personnel a detailed briefing on how the price was determined. Because of such intangibles as the "learning curve" proficiency, amortized special tooling, etc., UMTA further imposed a total profit limitation on the contract of 12 percent of the price of the cars. The prime purpose of a price and cost analysis is to assure that the price is fair and reasonable and, therefore, the contractor is not likely to make a windfall profit. With the price and cost analysis and the profit limitation clause in the contract, with right to audit, there is very little additional assurance that UMTA could obtain.

Detailed comments, where we disagree with specific statements in the digest and the discussion, are included as Attachment 1.<sup>2</sup>

In summary, the essence of sound contracting procedures is that the government or grantee receive goods or services at a fair and reasonable price. This procedure does not mandate the denial of advance payments, nor does it demand analysis beyond that which assures the contracting officer that the price is fair and reasonable. As stated in your report, UMTA's directives conform to Federal Administrative requirements for grants, as set forth in GSA Management Circular 74-7 (formerly OMB Circular A-102). In addition, that circular states that "No additional requirements shall be imposed by the Federal agencies upon the grantees unless specifically required by Federal law or Executive orders."

<sup>2</sup>

GAO note: Attachment 1 has been deleted; however, the detailed comments have been considered as necessary in the report.

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