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Decisions of the Comptroller General of the United States

DIGESTS

1. The Air Force did not violate the Antideficiency Act when it terminated a fixed-price-incentive contract for lack of funds. Termination of a contract prior to incurring obligations in excess of funds available in the appropriation account prevents an Antideficiency Act violation.
2. Projected cost overruns between the target and ceiling prices of a fixed-price-incentive contract are not de facto obligations. Until the contractor has a legal right to be paid for costs incurred, potential cost overruns are contingent liabilities.
3. Air Force regulations permit a procuring entity to limit the initial obligation on a fixed-price-incentive contract to the target price. Regulations also require the procuring entity to commit funds to cover the expected cost of contract. Failure to follow those regulations on the advanced cruise missile contract for fiscal year 1987, where overruns were foreseeable, resulted in insufficient funds being available when needed to complete the contract at the ceiling price.



United States
General Accounting Office
Washington, D.C. 20548

Office of the General Counsel

B-255831

July 7, 1995

Derek J. Vander Schaaf
Deputy Inspector General
Department of Defense

Dear Mr. Vander Schaaf:

You asked for our views on three questions concerning the Air Force's procurement of advanced cruise missiles (ACM) for fiscal years (FY) 1987 and 1988. The questions involve alleged violations of the Antideficiency Act pertaining to the FY 87 procurement. The Act, codified in part at 31 U.S.C. § 1341, prohibits federal employees from incurring obligations in excess of available funds. Attempting to avoid a violation of the Antideficiency Act, in April 1992 the Air Force terminated its contract for ACMs because projected cost overruns would have exceeded available funds. In this respect, we reported in 1994¹ that the ACM program had to be restructured dramatically in 1992 in key part because of the lack of funds to cover FY 87 and 88 cost overruns.

You question whether three separate aspects of the Air Force actions violated the Antideficiency Act. The first is the failure to commit funds to cover the ceiling price of the contract and the resulting projection of unfunded cost overruns. Second, you ask whether the Air Force violated the Act when it allowed contract performance to continue unabated until all available funds were exhausted. Third, you assert that costs actually incurred by the contractor prior to termination exceeded available funds in the account, thus causing a deficiency.

We do not believe that the Act was violated. While it is clear the Air Force could have done substantially more to manage the contract effectively, a projection of overruns does not in itself constitute an Antideficiency Act violation. Further, we see no violation in allowing contract performance to continue, as opposed to

¹STRATEGIC MISSILES: Issues Regarding Advanced Cruise Missile Program Restructuring, GAO/NSIAD-94-145 (May 1994).

terminating the contract based on the projection of overruns. Moreover, the Air Force's termination strategy avoided costs that, had the transaction been structured differently, may have caused a deficiency.

Our finding that the Air Force did not violate the Antideficiency Act should not be taken as an endorsement of its actions with regard to the FY 87 ACM procurement. In view of the difficult technical and cost problems that delayed contract definitization for a year and a half, the Air Force should have anticipated that cost overruns likely would take the contract to ceiling price. Yet, at the time of definitization, the Air Force did not act to commit sufficient funds in the appropriation account to complete the contract. Even after definitization, as the likelihood of overruns approached reality, the Air Force took no steps to manage the contract (e.g., cutting back the number of missiles), or the account (e.g., reducing other demands on the account), to cover the ceiling. Other than requesting additional funds from the Congress, this left the Air Force with only one practical option as costs continued to increase while the account was being exhausted: termination of the contract.

BACKGROUND

Contract Award and Performance History

In March 1986, the Air Force awarded an undefinitized contract to General Dynamics Corporation, Convair Division (GD/C), to begin production of advanced cruise missiles for FY 87 (referred to as "Lot III").² It was not until September 12, 1989, that the Air Force definitized this fixed-price-incentive (FPI) contract (No. F33657-88-C-0103).³ At definitization, the firm target price under the Lot III contract was \$537.2 million and the ceiling price was \$613.1 million for 150 missiles. The contract contained an option for an additional 100 missiles for FY 88 ("Lot IV") at a target price of \$231.7 million and a ceiling price of \$261.9 million. The contractor was to be liable for 30 percent of any overrun of the target cost, in the form of reduced profit; the ceiling price established the government's maximum liability. The Air Force exercised the Lot IV option on January 30, 1990.

Both before and after Lot III definitization, the serious design and production problems persisted on GD/C's 1985 and 1986 ACM contracts (Lots I and II). In November 1989, 2 months after definitization of Lot III, these continuing problems culminated in the Air Force ordering GD/C to halt deliveries of all missiles on all

²In August 1992, General Dynamics Convair Division was acquired by Hughes Corporation. This opinion will refer to the contractor throughout as GD/C.

³The definitized contract took effect on September 22, 1989, after approval by the Assistant Secretary.

production lots until the technical difficulties were resolved.⁴ In November 1990, GD/C formally alerted the Air Force to the probability that the difficulties would cause the Lot III contract to exceed the target cost by \$40.9 million. The contractor sought to correct the problems and eventually did so. Meanwhile, the Air Force was trying to verify the exact amount the contract costs would increase. The Air Force's final cost estimate was completed in October 1991, 11 months after the contractor's formal notice of increasing costs. By that time, however, the projected overrun for the contract had increased to approximately \$100 million.

Contract Funding

The Air Force definitized the Lot III contract just 2-1/2 weeks before the FY 87 Missile Procurement, Air Force account ("account 3020") was to expire, and obligated the account only for the target price. Air Force officials did not commit additional funds in the account to cover predictable cost overruns. As a result, when the cost overruns were later projected, the account balance was not sufficient to cover them.

An Air Force audit completed in September 1994 indicates that in order to cover the overruns Air Force officials had intended to seek access to the merged surplus account.⁵ The merged surplus account housed large unobligated balances without fiscal year identity that could be used for upward adjustments of obligations from expired fiscal years. However, those balances were canceled by statute in 1990.⁶ Because FY 87 and 88 funds were nearly exhausted and the merged surplus account was no longer available when the cost overruns were firmly estimated in the fall of 1991, the Air Force needed to find another source of funds, take some action to limit costs charged by the contractor, or request a deficiency appropriation.

The Air Force pursued only the first of those options, as Air Force officials began discussions with the Assistant Secretary of the Air Force (Financial Management and Comptroller) about funds to cover the projected overrun. In October 1991, these discussions culminated in requests for expired year funds. The amounts requested were \$71.5 million from FY 87 and \$27.1 million from FY 88. These requests were denied because such large amounts were not available.

⁴Deliveries did not resume until June 1990. This did not resolve all the problems, however. The Air Force again found it necessary to suspend deliveries, from April to October 1991. See STRATEGIC MISSILES: ACM Program. Opportunity for Additional Savings, GAO/NSIAD-92-154 (Nov. 1992).

⁵Report of Audit, Project 94063015, Sept. 9, 1994.

⁶Pub. L. No. 101-510, § 1405, 104 Stat. 1485, 1675, (1990).

Next, the Air Force asked to use FY 92 ACM funds to finish the Lot III and IV contract. The request relied on the theory that the new legislation allowed the use of current year funds to carry out contract changes within the original scope of work. The Assistant Secretary at first agreed with that position.⁷ Ultimately, the Department of Defense (DOD) Comptroller denied the request to use 1992 funds to complete the contract.⁸ When the use of current year funds finally was ruled out, the Air Force decided to terminate the contract for Lot III to prevent an Antideficiency Act violation. On April 6, 1992, the Air Force terminated the Lot III contract with GD/C for the convenience of the government. Days later, the Air Force also terminated 24 missiles from Lot IV. Only 54 of the 250 missiles in Lots III and IV had been delivered as of the date of termination.

Immediately prior to termination, obligations on the contract had reached \$565 million (\$28 million over target, and \$48 million below ceiling). On March 31, 1992, the FY 87 unobligated balance in account 3020 was \$25.188 million. The balance increased slightly as of the end of April 1992. According to the Air Force's calculations, termination prevented contractor-incurred costs from surpassing available budget authority. For that reason, Air Force officials believe their action avoided an Antideficiency Act violation.

Subsequent Procurement

Actions on Lots III and IV occurred against a backdrop of other changes to the ACM program. In January 1992, citing changing defense needs in the post-Cold War era, the President announced a major cutback in total ACM procurement. The President determined that only 640 missiles were needed, instead of the previously planned 1,000. On February 27, 1992, the Air Force program manager issued a stop work order for activities related to the FY 92 procurement of 120 ACMs.⁹ The stop work order directed GD/C immediately to suspend advance buy and long lead activities then underway for FY 92 and later years. The ACM program was later reduced still further to 520 missiles.¹⁰

⁷See GAO/NSIAD-92-154, supra.

⁸Memorandum from Sean O'Keefe to Assistant Secretary of the Air Force (Financial Management and Comptroller), Mar. 31, 1992.

⁹A second stop work order was sent to McDonnell Douglas Corporation, which had a contract as the second supplier of ACMs in FY 92.

¹⁰Additional program restructuring reduced the number of missiles the Air Force eventually acquired to 461. GAO/NSIAD-92-154, supra.

Two months later, the 1987-88 contract was terminated for lack of funds. The day after terminating the Lot III contract, the Air Force used 1992 funds to enter into a new sole-source contract with GD/C for 120 missiles at a firm, fixed price. This contract used 96 partially completed missiles from the terminated contract, and 24 that were about to be terminated from the Lot IV contract, as government-furnished equipment. These 120 missiles filled out the final missile complement of 520.

Congressional Ratification

On April 28, 1992, the Air Force notified the Senate Appropriations Committee of the termination of the FY 87 and FY 88 ACM production lots and the subsequent procurement of 120 missiles with FY 92 funds. Congressional response to that notification came on May 20, 1992, in the conference report on the 1993 rescission legislation. In that legislation, Congress rescinded \$344 million of the \$433.1 million originally appropriated for ACM procurement in FY 1992. Some of the \$89.1 million that was not rescinded had already been expended on the suspended 1992 long lead effort. As to the remainder, the conferees "specifically directed" the Air Force to use "remaining fiscal year 1992 funding . . . to complete the procurement of the fiscal year 1987 and 1988 missiles. . . ."¹¹

ANALYSIS

Antideficiency Act

An agency that obligates or expends funds in excess of the amount available in the appropriation account violates the Antideficiency Act. 31 U.S.C. § 1341. Inspector General Report No. 93-053, dated February 12, 1993, alleged three violations of the Antideficiency Act arising from the Lot III contract. First, the report asserted that because the government had a contract requiring it to pay the cost overruns, the prediction of unfunded overruns was a violation of the Antideficiency Act. Second, the report stated that the Air Force violated the Act when it failed to make immediate adjustments in funding sources, obligation levels, or contract requirements as soon as the escalating costs became apparent. Finally, the report suggested that the contractor did in fact incur costs in excess of available funds, thereby causing a deficiency.

The report's conclusion seems to proceed from the assumption that exposing the government to a situation in which liability for costs on a valid contract has the potential to exceed available appropriations violates the Antideficiency Act. We disagree. In this case, the Air Force initially obligated an amount equal to the target

¹¹H.R. Rep. No. 530, 102d Cong., 2d Sess. 28.

price of the contract, which is the accepted practice.¹² In terms of appropriation accounting, the difference between the target and ceiling prices is a contingent liability that may or may not require future obligations. An officer of the government violates the Act only by incurring or authorizing an obligation or making an expenditure that puts the appropriation account in a deficiency status. That did not happen here. Because the Air Force terminated the contract, no obligation was ever incurred or authorized for the unfunded portion of the projected overrun.

An agency faced with a possible violation of the Antideficiency Act has a duty to act to prevent the violation or at least to mitigate its consequences. One example of government action that would reduce the contingent liability would be the modification of the contract to include design or quantity changes that would allow the contract to be completed within available funds. In fact, your criticism of Air Force officials for not taking such steps implicitly recognizes that such actions would avoid an Antideficiency Act violation.¹³

Another option to avoid a possible Antideficiency Act violation is termination of the contract for the convenience of the government. Termination is the ultimate tool at the government's disposal to prevent a contractor from incurring costs beyond the account's limit. Convenience termination of a contract to prevent an Antideficiency Act violation is a drastic measure with serious consequences. Termination costs can be substantial. Moreover, the government loses the value of its original bargain with the contractor.

Despite its negative aspects, however, termination for the convenience of the government is an effective means of avoiding an Antideficiency Act violation. As we said in 55 Comp. Gen. 768, 773 (1975), termination "will fix the Government's final obligation . . . at the amount payable pursuant to the Termination for Convenience clause." If that amount is less than what would otherwise be due under the contract, termination is "the most that can be done" to prevent a violation. In that case, the violation was so large that contract termination was sufficient only to reduce it. In the current circumstances, the Air Force, in terminating the contract for convenience, minimized the attendant costs so as to successfully avert a violation.

¹²See, e.g., Federal Acquisition Regulation, 48 C.F.R. § 32.703-1.

¹³To the extent that deobligation of other funds in the account was possible, that would also have prevented an Antideficiency Act violation in the circumstances described. Deobligation, however, could have a negative programmatic impact on the "donor" program or programs.

In this respect, it has been suggested that the Lot III termination costs exceeded the amount remaining in the 3020 account. If that were true, the need to pay termination costs with FY 87 funds might have caused an Antideficiency Act violation. The Air Force has reported, however, that sufficient funds were available at all times to cover all contract and termination costs. The way the transaction was structured, that appears to be an accurate statement.

The use of the 1992 letter contract allowed GD/C and the Air Force to avoid the expenses normally associated with terminating a contract for the convenience of the government.¹⁴ Because its work was not interrupted, GD/C sustained minimal termination related costs. In fact, GD/C was willing and agreed to perform on the letter contract for approximately the same total amount as would have been paid under the Lot III contract, including the 30/70 cost sharing ratio.

At the time of termination, the prime contractor had outstanding subcontracts worth \$7.6 million. The subcontracts were orders for materials, parts, and supplies GD/C placed with subcontractors before the Air Force terminated the contract. Upon termination, the unliquidated payments due subcontractors became potential termination expenses of Lot III. Under the termination clause in the contract, the contracting officer may approve, as a part of the termination agreement, the prime contractor's proposed termination settlement with its subcontractors. See 48 C.F.R. § 52.249-2. Here, because its performance on the letter contract would have required it to obtain the same items previously subcontracted, GD/C apparently elected to continue rather than terminate the subcontracts. The result was that costs that might have been associated with terminating the subcontracts were avoided.¹⁵

Another element of cost avoidance was the letter contract's direction that partially assembled missiles from Lot III and other related inventory in the contractor's possession be used in its performance. The Federal Acquisition Regulation confers broad discretion on a contracting officer to make termination arrangements that are fair and reasonable. 48 C.F.R §§ 49.103 and 49.105(c). The Lot III termination achieved that objective.

¹⁴The Air Force was able to make use of the letter contract because, as discussed earlier, it needed 120 missiles to reach the full missile complement of 520, and had an FY 92 authorization and appropriation to buy them.

¹⁵In any event, the 3020 account balance of \$25 million at the time of termination would have been sufficient to cover the \$7.6 million in subcontract costs, had that become necessary.

Funding and Contract Management

As stated at the outset of this letter, the Air Force's successful avoidance of an Antideficiency Act violation does not mean that its actions in this situation should be condoned. It was the Air Force's own failure to deal with serious funding issues effectively and timely that placed it in a position where it needed to take drastic contract action to avoid violating the law.

In our view, the Air Force should have known well before contract definitization that it would not be able to pay for the number of missiles required in the letter contract with the funds it would have available. GD/C had experienced numerous problems, and cost overruns, on the Lots I and II contracts for ACMs. Moreover, work on the Lot III contract was well under way by the time of definitization in September 1989. The negotiations leading up to definitization were unusually lengthy and had to alert the parties to technical problems substantial enough that their resolution would materially affect the contract costs. Accordingly, we think that Air Force officials either knew or should have known there was a significant risk that the Lot III contract as structured would reach its ceiling price.

The Air Force, pursuant to its own regulations and DOD accounting procedures, should have taken actions to commit funds in the appropriation account to cover foreseeable cost overruns up to the ceiling price. The Air Force and DOD accounting manuals have procedures for recording obligations in connection with incentive contracts.¹⁶ Although the manuals state that the minimum obligation to be recorded at contract award is the target or base price (which is what the Air Force did),¹⁷ the same manuals provide guidance on how to plan for overruns to the ceiling price. The manuals direct the contracting agency to estimate the amount by which a FPI contract is anticipated to exceed its target. The agency then is to "commit," or reserve, the estimated amount, so that funds will be assured to cover foreseeable cost overruns.¹⁸ An agency that fails, as the Air Force did, to commit

¹⁶Air Force Regulations 170-8, Accounting for Obligations, and 170-13, Accounting for Commitments; DOD Instruction 7220.9-M, Standards for Recording Commitments and Obligations.

¹⁷This practice is also approved in the Federal Acquisition Regulation at 48 C.F.R. Part 32.703-1, and in the GAO Fiscal Policy and Procedures Manual for the Guidance of Federal Agencies, title 7, § 3.4.C.

¹⁸The directives and the manuals do not require an agency to commit the full ceiling price in each instance. Instead, they require the officials to use their best judgment of the amount of funds that will be needed, and they encourage realistic estimates. An agency also has the option of obligating the additional funds instead of committing them.

funds in the account to cover cost increases to the ceiling price runs the risk of facing unfunded contract liabilities and Antideficiency Act problems. Had the Air Force followed established procedures for committing funds, the account might have been able to support the contract,¹⁹ and there would have been no need to terminate the contract or look to the merged surplus account for funds.

Further, to the extent the Air Force may not have been fully aware on or before definitization exactly how bad the Lot III situation would be, it certainly knew the target price would be breached well before the actual termination decision. GD/C advised the Air Force almost 1-1/2 years before termination that it would exceed the target cost by more than \$40 million. We recognize that the precise quantum of the problem may not have been known until later, but its significance certainly was.

In its report on ACM Contracting and Financial Activities,²⁰ the Air Force Audit Agency found that the Air Force did not use available tools and processes for identifying and quantifying the contract's over-target condition. The report specifically criticized managers' neglect of accurate accountability over changes in the contract values, and senior managers' failure to take timely action in response to early indications of target overruns.²¹ The audit agency further concluded that the Air Force's failure to explore ways to cure the funding situation essentially was caused by program officials' anticipation that the merged surplus account would be available, as it historically had been, to fund the Air Force's share of over-target costs. As stated above, however, the Congress canceled those unobligated balances in 1990. That legislation was based in large part on the Congress's general concern that controls over the use of appropriations were not effective, but also on its finding that DOD in particular was spending merged account funds without sufficient assurance that there was authority for the expenditures or in ways that the Congress did not intend.²²

¹⁹The contract was definitized on September 12, 1989. At the end of the prior month, there was enough money in account 3020 to cover the ceiling. By the end of September, however, the unobligated account balance was only \$48.6 million, whereas the target/ceiling difference was \$76 million, as we reported in May 1994. The account balance on September 12 is not available.

²⁰Report of Audit, Project 94063015, Sept. 9, 1994.

²¹For example, the Air Force did not convene a senior review team to address contract and funding problems.

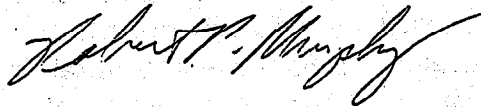
²²See 72 Comp. Gen. 343, 345 (1993).

CONCLUSION

While there is no Antideficiency Act violation in the current facts, the Air Force failed to commit funds for reasonably predictable cost overruns. We pointed out as long ago as 1955 that when an obligation is recorded at the target price, failure to reserve funds up to the ceiling price exposes the contracting agency to the risk of an Antideficiency Act violation. 34 Comp. Gen. 418 (1955). Moreover, the Air Force did not make use of other opportunities to avoid termination of the Lot III contract by taking effective, affirmative measures to manage costs or reduce quantities.

We trust the foregoing is helpful to you.

Sincerely yours,

A handwritten signature in dark ink, appearing to read "Robert P. Murphy". The signature is fluid and cursive, with the first name "Robert" and last name "Murphy" being clearly legible despite the cursive style.

Robert P. Murphy
General Counsel



Comptroller General
of the United States

Washington, D.C. 20548

Decision

Matter of: Roland R. Leaton

File: B-261168

Date: July 18, 1995

DIGEST

Federal Travel Regulation provision governing reimbursement of temporary quarters subsistence expenses grants agencies discretion, in cases where transferred employee claims temporary use of permanent-type quarters at new duty station, to determine whether employee intended to occupy those quarters on a temporary basis only. To qualify for reimbursement of these expenses, employee has burden of providing evidence of such intent satisfactory to agency. Agency's determination that evidence is insufficient will not be overturned unless it lacks reasonable basis in the record and thus constitutes an abuse of discretion. Agency's determination upon appeal in this case that employee failed to provide satisfactory evidence of intent to occupy permanent-type quarters only temporarily is not without substantial support in the record, and, therefore, is affirmed.

DECISION

BACKGROUND

An employee of the Bureau of Land Management (BLM), Mr. Roland R. Leaton, appeals our Claims Certificate Z-2869062, dated May 11, 1994, denying reimbursement of temporary quarters subsistence expenses incident to a permanent change of station from Bixby, Oklahoma, to Elkhart, Kansas. We sustain the disallowance.

Mr. Leaton arrived for duty in Elkhart on June 16, 1993. He was authorized 30 days' subsistence expenses beginning June 16, 1993. From June 16 through June 29, 1993, he resided in a motel in Elkhart. On June 30, Mr. Leaton moved into a single family residence at 831 S. Stanton Street, Elkhart, which he rented on a day-to-day basis through August 19, 1993. His wife joined him on July 4, 1993. In July, Mr. Leaton requested and was granted a 30-day extension of the subsistence expense allowance covering the period from July 16 to August 14, 1993. He was reimbursed for the first 30 days by offset against his travel advance.

PUBLISHED DECISION
74 Comp. Gen. _____

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Mr. Leaton asserts that he began his search for permanent housing in June. On August 2, 1993, he inquired at the First National Bank of Elkhart about financing for purchase of real estate, but was turned down because of a negative credit report on file at the bank.

On August 12, 1993, Mr. Leaton approached the rental agent for the residence he was occupying to ask about a long-term lease for this residence. On August 15, 1993, Mr. Leaton and the agent agreed, based on a draft drawn up by the agent, on a long-term lease effective August 20, 1993, for occupancy of the residence at 831 S. Stanton, with an option to buy at a later date. The lease was signed September 24, 1993. Mr. Leaton took delivery of his household goods on August 27, 1993. He and his family continue to live at this residence.

On October 12, 1993, Mr. Leaton requested reimbursement of expenses he incurred during the second 30 days' temporary quarters (July 16, 1993 - August 14, 1993). BLM denied the claim for temporary quarters for the second 30 days when its audit of the claim revealed that Mr. Leaton had entered into a lease agreement and option to purchase the same residence claimed as temporary quarters. BLM also issued a Bill of Collection to Mr. Leaton for the expenses he had been reimbursed for the period beginning June 30, 1993, the day he moved into the house on S. Stanton.

Mr. Leaton appealed to GAO stating that prior to August 20, 1993, the effective date of the lease/option to purchase agreement on the house, he had not intended to make the house his permanent residence. Our Claims Group denied his claim on the basis that the record supported BLM's determination that Mr. Leaton failed to provide sufficient evidence of an intent to occupy the living premises on a temporary basis. Mr. Leaton now appeals the denial of temporary quarters expenses, continuing to assert that he did not intend to make the house his permanent residence until August 1993.

ANALYSIS AND CONCLUSION

Chapter 302, Part 5, Section 2(c) of the Federal Travel Regulation (FTR) (41 C.F.R. § 302-5.2(c) (1994)) states that occupancy of temporary quarters that eventually become the employee's permanent quarters shall not prevent payment of the temporary quarters allowance if, in the agency's judgment, the employee shows satisfactorily that occupancy of the quarters was intended initially to be only temporary. The employee has the burden of providing evidence of such intent which is satisfactory to the agency. The agency's determination that the evidence is insufficient to show such intent will not be overturned by our Office unless it lacks any reasonable basis in the record and thus constitutes an abuse of discretion. Richard A. Alschuler, 71 Comp. Gen. 389 (1992) and Arthur Obester, B-249174, August 7, 1992.

When reviewing the agency determination, we have looked to the factors listed in FTR § 302-5.2(c) in considering whether an employee who occupies permanent-type quarters intends to do so only temporarily, recognizing that the employee has the burden of providing convincing evidence of such intent. See, e.g., Myroslaw J. Yuschishin, B-194073, June 18, 1979, and decisions cited. We have considered such factors as the type of quarters, the duration of a lease, the movement of household effects into the quarters, efforts to secure a permanent residence, expressions of intent, and any other pertinent facts and circumstances surrounding the occupancy. If on the basis of these considerations it is objectively determined that at the time the employee moved into the residence, he clearly manifested the intent to occupy the quarters only on a temporary basis, we have allowed payment of subsistence expenses, even though the quarters could be occupied permanently or did, in fact become permanent. See Robert D. Hawks, B-205057, February 24, 1982, and Elven E. Conklin, B-184565, February 27, 1976.

In Mr. Leaton's case, it is clear that BLM performed the analysis required by FTR paragraph 2-5.2c, supra, and applied the factors set forth in that paragraph. Although he claimed to have actively sought permanent housing since June, Mr. Leaton did not provide documentary evidence of any type to substantiate house hunting activities. While he points to his attempt to secure financing for purchase of real estate from the First National Bank of Elkhart as evidence he was in the market for a permanent residence, the evidence that he sought the loan for any property other than the South Stanton Street residence is not persuasive.¹ In addition, BLM found that the South Stanton Street property was on the market for lease or sale at the time he took residence. BLM confirmed that rentals were available in Elkhart at much less than the amount Mr. Leaton paid for renting this residence. Additionally, the agency determined that Mr. Leaton's claims for meals were excessive and unreasonable. Considering these factors, we conclude that the agency's original determination—that it was unconvinced by Mr. Leaton's offering of evidence that he clearly intended to occupy the residence on a temporary basis only—is not without substantial support in the record before the agency.²

¹The bank initially indicated in a December 1993 letter to BLM that it understood Mr. Leaton's request was for a loan to purchase the S. Stanton Street residence. Later, in January 1995, at the request of Mr. Leaton, the bank sent a second letter noting that the assumption made in the first letter that Mr. Leaton was interested in the specific property may have been in error.

²We note also that Mr. Leaton's household effects were tentatively scheduled to be delivered in Elkhart on August 13, 1993. When he was turned down for financing, Mr. Leaton informed the moving company on August 9, 1993, that he needed to postpone delivery. Clear evidence of any possible permanent residences for

(continued...)

We have carefully reviewed additional information submitted to our Office by Mr. Leaton as a part of his appeal. The additional correspondence consists of a letter from an attorney representing Mr. Leaton with attachments. We conclude that this additional information is insufficient to call into question the basis of the BLM determination. We also asked BLM to review this correspondence; the agency found no basis in it for reconsidering its original determination.

Accordingly, the denial of temporary quarters subsistence expenses after June 29, 1993, is sustained.

for *Lynne E. Fox*
Robert P. Murphy
General Counsel

²(...continued)

Mr. Leaton other than the South Stanton Street address is not provided in the record. There is no suggestion in the record that Mr. Leaton planned to place his household goods in storage pending completion of his house-hunting. A planned delivery at the S. Stanton address is further indication of an intent to make it more than a temporary residence.



Comptroller General
of the United States

Washington, D.C. 20548

Decision

Matter of: Federal Aviation Administration--Appropriations Availability--Payment of Attorney's Fees

File: B-257061

Date: July 19, 1995

DIGEST

The Federal Aviation Administration must use appropriations available at the time of award to pay attorney's fees resulting from a discrimination complaint. Appropriations available in a prior fiscal year, when the complaint was filed, are not available for this purpose.

DECISION

This responds to a request under 31 U.S.C. § 3529 for an advance decision concerning whether the Federal Aviation Administration (FAA), Department of Transportation, can use fiscal year 1992 appropriations to pay an employee's attorney's fees that FAA awarded in fiscal year 1994. As explained below, we conclude that FAA must use fiscal year 1994 appropriations to pay the fees.

On January 21, 1992, Carol A. Rogers filed an equal employment opportunity complaint against FAA. After a hearing before an Equal Employment Opportunity Commission administrative judge, FAA issued a decision in fiscal year 1994, holding that Ms. Rogers had been discriminated against on the basis of sex and age. FAA then awarded Ms. Rogers a promotion, back pay, compensatory damages and attorney's fees.

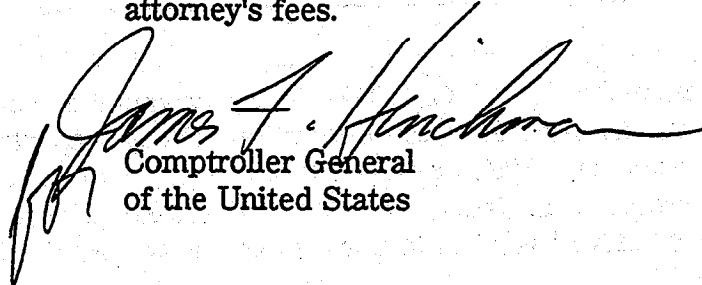
By memorandum of March 18, 1994, FAA ordered the payment of \$28,573.31 in attorney's fees to Ms. Rogers. However, the memorandum cited FAA's fiscal year 1992 appropriation as the source for the payment. The certifying official questioned the use of the 1992 appropriation and requested our guidance.

As a general rule, an agency must pay a claim from the appropriation available for the fiscal year in which the amount of the claim was determined and allowed. B-216351, July 25, 1988. The date that the claim becomes a legal liability determines the fiscal year appropriation to be used to pay the claim. 27 Comp. Gen. 237, 238 (1947). This rule is grounded in the theory that an administrative

award "creates a new right" in the successful claimant, giving rise to a new government liability. 63 Comp. Gen. 308, 310 (1984). Since FAA made its administrative determination in fiscal year 1994, FAA must use its 1994 appropriations to pay the attorney's fees award.¹

The FAA certifying official also asked whether the agency could have used its fiscal year 1992 appropriations to pay the award if it had previously reserved the funds in a contingency account to cover the possibility of a future award of attorney's fees. Unless FAA had statutory authority to extend the availability of annual appropriations over several fiscal years by reserving budget authority in a contingency account, the funds reserved in such an account would have expired at the end of fiscal year 1992. See 58 Comp. Gen. 321 (1979). It is a fundamental principle of appropriations law that appropriated amounts are limited for obligation to a definite period and are available only for payment of expenses properly incurred during that period of availability. 31 U.S.C. § 1502. Hence, unless properly obligated during their period of availability, any amounts reserved in a contingency account would not be available to support obligations arising after the expiration of their period of availability.

Accordingly, FAA must use fiscal year 1994 appropriations to pay Ms. Rogers' attorney's fees.


Comptroller General
of the United States

¹ Title VII of the Civil Rights Act of 1964 authorizes the award of attorney's fees in settlement agreements involving sex discrimination. See 42 U.S.C. § 2000e-16; 29 C.F.R. § 1613.271(d).



Decision

Matter of: Price Waterhouse--Claim for Costs

File: B-254492.3

Date: July 20, 1995

David R. Johnson, Esq., and David A. Levine, Esq., Gibson, Dunn & Crutcher, for the protester.
Marie N. Adamson, Esq., and Michelle Harrell, Esq., General Services Administration, for the agency.
Christine F. Davis, Esq., and James A. Spangenberg, Esq., Office of the General Counsel, GAO, participated in the preparation of the decision.

DIGEST

1. Protester should not be paid costs incurred in filing and pursuing an unsuccessful initial protest, where that protest is readily severable from a successful supplemental protest, which rested upon a different set of facts and relied upon unrelated legal theories.
2. Excessive attorney hours are not recoverable protest costs, but an agency must identify specific hours as excessive and articulate a reasoned analysis as to why payment for such hours should be disallowed.
3. Protester may recover the costs incurred by its two attorneys, who worked together to prepare questions for witnesses testifying at a bid protest hearing, because the joint effort was necessary for the development of a coordinated hearing strategy and did not result in duplicative or excessive costs.
4. Protester may not recover the costs incurred in preparing for and conducting settlement discussions with the procuring agency regarding a protest filed at the General Accounting Office (GAO), since such costs were not incurred in pursuit of the GAO protest.
5. Protester may not recover costs incurred after its protest was sustained in evaluating how the General Accounting Office's recommendation for corrective action should be implemented, since the contracting agency, not the protester, is responsible for the details of implementing a recommendation for corrective action.

6. Protester is entitled to recover the costs incurred after its protest was sustained for returning protected documents in accordance with a protective order and responding to unsupported agency allegations of protective order violations.

7. Costs incurred in pursuing protest claim at contracting agency are not recoverable.

DECISION

Price Waterhouse requests that our Office recommend to the General Services Administration (GSA) the amount GSA should pay for the protester's costs of filing and pursuing its bid protest, which we sustained in Price Waterhouse, B-254492.2, Feb. 16, 1994, 94-1 CPD ¶ 168.

On August 13, 1993, Price Waterhouse protested GSA's award of a contract to Arthur Andersen & Co. under request for proposals (RFP) No. FCXA-SN-92009-N. The RFP solicited audit services from an independent public accounting firm and provided for award based upon the "most advantageous" proposal, considering price and technical factors.

Price Waterhouse initially protested that the RFP established a low-priced, technically acceptable evaluation scheme, which precluded award based upon Arthur Andersen's higher-priced proposal. GSA filed its report on the protest on September 20, which showed that the agency had actually rejected Price Waterhouse's proposal as technically unacceptable because its proposed level of effort was considered insufficient. Price Waterhouse filed report comments on October 4 in which it raised several new issues relating to GSA's rejection of its proposal as technically unacceptable. In particular, the protester argued that GSA used an undisclosed minimum labor hour requirement in evaluating proposals and failed to conduct meaningful discussions in this respect. Our Office treated the protester's comments as a supplemental protest and obtained a GSA report on the matter. On December 2, our Office conducted a hearing with regard to the supplemental protest allegations, at which there was testimony from two witnesses, the contracting officer and the source selection evaluation board (SSEB) chairman, concerning how the agency evaluated offerors' proposed labor hours and how the agency communicated its labor hour expectations during discussions. On December 20, after receiving the parties' hearing comments, our Office consolidated Price Waterhouse's initial and supplemental protests. We issued a consolidated decision on February 16, 1994.

In our decision, we found that GSA failed to conduct meaningful discussions by twice requesting best and final offers (BAFO) from Price Waterhouse without apprising the firm that its otherwise acceptable proposal contained a deficiency--a proposed level of effort that was considered unacceptably low--that rendered its proposal technically unacceptable. We recommended that GSA reopen negotiations, request a new round of BAFOs, and either affirm or terminate Arthur Andersen's contract depending upon the results of the reevaluation. We also found that Price Waterhouse was entitled to recover its costs of filing and pursuing its protest, including reasonable attorneys' fees.¹

Price Waterhouse submitted a claim for costs in the amount of \$117,506.64 to the agency. GSA determined that Price Waterhouse was entitled to recover \$82,250.87. Price Waterhouse disputes GSA's determination and asks that we determine the amount to which it is entitled pursuant to 4 C.F.R. § 21.6(f)(2) (1995). We determine that Price Waterhouse is entitled to recover \$100,861.73.

ALLOCATION OF COSTS TO ISSUES

GSA first maintains that Price Waterhouse should not be reimbursed for the costs associated with filing and pursuing its initial protest allegation, *i.e.*, whether the RFP established a low-priced, technically acceptable evaluation scheme which GSA allegedly ignored in making award to Arthur Andersen. The agency claims that this allegation was rejected by our Office and is clearly severable from the protester's successful allegation that GSA conducted misleading discussions.

As a general rule, we consider a successful protester entitled to costs incurred with respect to all issues pursued, not merely those upon which it prevails. Omni Analysis; Department of the Navy--Recon., 68 Comp. Gen. 559 (1989), 89-2 CPD ¶ 73. Nevertheless, we will limit a successful protester's recovery of protest costs where a part of its costs is allocable to a losing protest issue that is so clearly severable as to essentially constitute a separate protest. Department of the Navy--Recon. and for Modification of Remedy, B-246784.4, Feb. 17, 1993, 93-1 CPD ¶ 147; Interface Flooring Sys., Inc.--Claim for Costs, 66 Comp. Gen. 597 (1987), 87-2 CPD ¶ 106; see Komatsu Dresser Co., 71 Comp. Gen. 260 (1992), 92-1 CPD ¶ 202.

¹The decision was issued under the coverage of a protective order because of the ongoing nature of the procurement. We subsequently requested proposed redactions from the parties and prepared a redacted version of the decision for public distribution.

Price Waterhouse argues that our Office did not reject its allegation that the RFP established a low-priced, technically acceptable evaluation scheme and that it should be considered successful on this issue. We disagree. Although we did not expressly deny this protest basis, it was obvious from our description of the RFP, which clearly set forth a "best value" evaluation scheme, that the protester's initial protest lacked merit.

In addition, we find that this issue is readily severable from the issues raised in Price Waterhouse's supplemental protest, including those on which it ultimately prevailed. Price Waterhouse's initial protest--which was filed before the September 20 agency report--was not based upon the facts and legal theories that formed the crux of its supplemental protest, namely, the agency's approach to evaluating offerors' labor hours and the agency's communication of its labor hour expectations during discussions. Price Waterhouse's supplemental protest, which stemmed from these facts, was virtually unrelated to the initial protest, aside from maintaining the initial protest ground.

The mere fact that all protest allegations challenge the award to Arthur Andersen does not intertwine the issues. Issues are intertwined where they share a common core of facts, are based upon related legal theories, and are otherwise readily severable. See Department of the Navy--Recon. and for Modification of Remedy, supra; Data Based Decisions, Inc.--Claim for Costs, 69 Comp. Gen. 122 (1989), 89-2 CPD ¶ 538; Princeton Gamma-Tech, Inc.--Claim for Costs, 68 Comp. Gen. 400 (1989), 89-1 CPD ¶ 401. Since Price Waterhouse's initial and supplemental protests do not share a common factual and legal basis, but effectively constitute discrete and severable claims, we find that the protester is not entitled to the costs that are specifically allocated to filing and pursuing the initial protest ground. We therefore disallow costs in the amount of \$5,448.75, which were incurred prior to September 20--the date Price Waterhouse received the agency report that gave rise to the supplemental protest.²

²As indicated below, the only allowable costs incurred before September 20 are the costs incurred by Price Waterhouse's in-house attorney relating to his application for admission to the protective order. Also, while the protester continued to argue its initial protest ground in its supplemental filings, the costs incurred for this reason, which appear to be relatively minimal, are not readily severable from the supplemental protest costs and are recoverable. For example, GSA disallowed the hours charged by Price Waterhouse's in-house counsel in reviewing

(continued...)

REASONABLENESS OF ATTORNEYS' HOURS

GSA contends that the total attorney time billed for filing and pursuing the protest is excessive. GSA has identified several tasks that allegedly reflect unreasonably duplicative or excessive effort. GSA asks that we disallow a total of \$8,876.12 for such efforts as indicated below.³

We generally accept the number of attorney hours claimed, unless the agency identifies specific hours as excessive and articulates a reasoned analysis as to why payment for those hours should be disallowed. Omni Analysis--Claim for Costs, 69 Comp. Gen. 433 (1990), 90-1 CPD ¶ 436. Simply concluding that the hours claimed are excessive or suggest duplication of effort is inadequate to justify denying a claim for protest costs. Data Based Decisions, Inc.--Claim for Costs, supra; Princeton Gamma-Tech, Inc.--Claim for Costs, supra. We will examine the reasonableness of the attorney hours claimed to determine whether they exceed, in nature and amount, what a prudent person would incur in pursuit of his protest. Id.

GSA first disputes the time spent by Price Waterhouse's in-house counsel for various tasks.⁴ For example, GSA asserts that this counsel did not require the 13 1/2 hours claimed to prepare his application for admission to the protective order covering the protest.

While we agree that the number of hours claimed is on the high end, they have not been shown to be excessive in the circumstances. Our Office issues protective orders to allow counsel for protesters and interested parties access to confidential or proprietary information whose release may result in a competitive advantage. Protective orders are intended to protect and prevent the unauthorized release of protected information. It is very important to the integrity of the protest process for counsel, who may be unfamiliar with the terms of our protective order, to read and understand their obligations under the protective order.

²(...continued)

an affidavit of a Price Waterhouse employee, but this affidavit is in support of all of Price Waterhouse's protest contentions, including those upon which Price Waterhouse prevailed.

³Price Waterhouse objects to GSA's position in this regard on all counts, except with respect to one \$36.33 reduction in its claim, which we therefore disallow.

⁴The agency does not dispute the reasonableness of the hourly fee charged by this attorney.

Moreover, there are unique considerations regarding the admissibility of in-house counsel to a protective order issued by our Office that may require that individual to research pertinent precedent of our Office and the courts in order to ascertain whether he or she can be admitted to the protective order, and to prepare the required detailed application and affidavit seeking admission. In addition, in this case the in-house counsel's request for admission to the protective order was opposed by the agency, which required the preparation of a supplemental affidavit to overcome the agency's specific objections to his admission. Under the circumstances, we do not believe the claimed hours relating to the preparation of his application for admission to the protective order have been shown to be excessive. See Fritz Co., Inc.--Claim for Costs, B-246736.7, Aug. 4, 1994, 94-2 CPD ¶ 58.

GSA contends that the protester's in-house counsel also spent an excessive amount of time reviewing the agency's notice to authorize contract performance notwithstanding the protest, pursuant to CICA's "best interest" clause. See 31 U.S.C. § 3553(d)(2)(A)(i). The attorney billed 4.5 hours (\$653.85) for reviewing the notice, researching its impact on a possible remedy, and briefing his client on his findings. GSA contends that the attorney should have been able to accomplish these tasks in 1.5 hours. We agree. The override notice was only 1-1/2 pages long, and the research necessary to interpret it was minimal, e.g., CICA expressly discusses the impact of a "best interest" override on our recommendation. See 31 U.S.C. §§ 3553(d)(2)(A)(i), 3554(b)(2). Accordingly, we disallow payment for 3 excessive hours in the amount of \$435.90.

GSA disputes that the protester's in-house counsel needed 1 hour to review and research our notice consolidating Price Waterhouse's initial and supplemental protests, given the brevity of that document. We do not find the protester's claim to be excessive in the circumstances, since our Office does not generally consolidate protests and Price Waterhouse's counsel was not familiar with this procedure.

GSA also contends that the protester's in-house counsel did not need 15.5 hours to propose redactions to the protected decision issued by our Office on February 16, 1994. GSA states that the proposed redactions should have taken half that time (7.75 hours) and asks that we reduce the protester's claim by \$1,126.08.⁵

⁵In addition, one of the protester's outside counsel, a law firm associate, spent 2 hours (\$420) making redactions. Although GSA disallowed this amount, it has not articulated any reason as to why these costs are not allowable.

Price Waterhouse notes that a dispute arose between the parties regarding what information should be redacted from the published decision. Specifically, the agency and the interested party requested extensive redactions to the final decision, and Price Waterhouse states that not only did our Office largely adopt Price Waterhouse's suggested redactions, but it spent much of the time claimed "opposing the efforts of the GSA and Arthur Andersen to portray selectively the facts of the [d]ecision with the effect, if not the purpose, of concealing improprieties in the procurement."

We believe that Price Waterhouse has reasonably supported the time spent during the redaction process. Not only did Price Waterhouse prepare its own redactions to the decision, which our Office essentially adopted, it also incurred costs opposing the extensive redactions proposed by the agency and the interested party. We find the time spent by Price Waterhouse in proposing redactions in the final decision was not excessive in the circumstances.

The agency next argues that the protester's in-house and outside counsel (a law firm partner) duplicated each other's effort in preparing for the hearing conducted in the protest. The two attorneys worked together to prepare questions for both witnesses who testified at the hearing. GSA argues that, because the in-house counsel only questioned the contracting officer, he should not recover the costs of preparing questions for the SSEB chairman. Similarly, GSA argues that, because the outside counsel only questioned the SSEB chairman, he should not recover the costs of preparing questions for the contracting officer. GSA accordingly recommends that we reduce each attorney's reimbursement by 50 percent.⁶

Were we to deny an attorney the costs of assisting co-counsel in preparing questions for a witness, we would effectively deprive attorneys of the ability to develop a coordinated hearing strategy. We think it is unreasonable to adopt a rule that would encourage two attorneys preparing for the same hearing to work in isolation of each other. Although the number of attorneys employed may be a consideration, we have held that the essential question is

⁶The in-house counsel billed 37.5 hours preparing for the hearing for a total charge of \$5,448.75. The outside counsel billed 19.5 hours preparing for the hearing for a total charge of \$6,825. GSA requests that we reduce the total claim by 50 percent, which would amount to a \$6,136.88 reduction.

the reasonableness of the total hours billed. See Armour of Am., Inc.--Claim for Costs, 71 Comp. Gen. 293 (1992), 92-1 CPD ¶ 257. Here, GSA does not question the need for two attorneys to prepare for the hearing, nor does it specifically assert that the total number of hours billed was unreasonable. In our view, Price Waterhouse's attorneys did not spend excessive time preparing for the hearing and they may recover all costs incurred.

SETTLEMENT COSTS

GSA next contends that Price Waterhouse is not entitled to \$8,489.60 in claimed costs allegedly incurred in attempting to persuade the agency to take corrective action in response to its protest, inasmuch as these costs were not incurred "in pursuit" of the protest.⁷ See 31 U.S.C. § 3554(c)(1)(A) (1988); Techniarts Eng'g--Claim for Costs, 69 Comp. Gen. 679 (1990), 90-2 CPD ¶ 152; Diverco--Claim for Costs, B-240639.5, May 21, 1992, 92-1 CPD ¶ 460.

Price Waterhouse now concedes that it is not entitled to the costs incurred in preparing for, and attempting to reach, a negotiated settlement of its protest with GSA. However, it asserts that GSA has unreasonably disallowed all costs billed by the outside counsel on the same day as the settlement discussions, even though, as indicated on the outside counsel's supporting documentation, only a portion of these costs related to the settlement discussions and rest were in pursuit of the protest. Thus, Price Waterhouse reduced its claim by \$2,714.60 and has produced adequate documentation, in the form of a detailed affidavit from the outside counsel, establishing that the other costs incurred on those days were reasonably in pursuit of the protest.

GSA continues to assert that the entire \$8,489.60 should be disallowed because Price Waterhouse's outside counsel did not provide to GSA an adequate breakdown of the claimed hours when requested to do so by the agency. The record shows that GSA only requested a breakdown by protest issue, but did not ask that the costs associated with the settlement discussions be segregated. Since GSA does not challenge the documentation submitted, only the withdrawn \$2,714.60 in costs should be disallowed and the remainder of the costs in question should be reimbursed.

⁷The record reflects that Price Waterhouse commenced efforts to negotiate a settlement of its protest with the agency on November 22, after our Office notified the parties of our intention to conduct a hearing. Settlement discussions concluded unsuccessfully on November 30, 2 days before the hearing was held.

POST-DECISION COSTS

GSA argues that Price Waterhouse incurred certain unallowable costs after we issued our decision on February 16, 1994. Excluding the hours spent redacting our final decision, the protester charged 41.8 hours of attorneys' time after the decision was issued, for a total charge of \$10,835.10.⁸ GSA maintains that we should disallow all post-decision costs, except those incurred in analyzing the decision and preparing redactions.

As noted by GSA, our Office has recognized that the filing and pursuit of a protest includes, at least to some extent, an analysis of the ultimate decision and some explanation and consultation with the client. See Bay Tankers, Inc.--Claim for Costs, B-238162.4, May 31, 1991, 91-1 CPD ¶ 524. The record shows that Price Waterhouse's attorneys spent 4 hours doing such work for a total charge of \$683.55, and GSA has not articulated any basis for disallowing such costs.

The protester's attorneys also billed 28.25 hours, or \$7,116.10, for evaluating how to implement our recommendation for corrective action, which GSA asks that we disallow. Price Waterhouse contends that it should be reimbursed these costs because "the parties spent considerable time evaluating the decision and talking to each other about how the GAO's remedy could be implemented." Price Waterhouse argues that its consideration of how to implement the remedy was "consistent with the GAO's prescription that parties be allowed time to analyze the ultimate decision."

The details of implementing one of our recommendations for corrective action are within the sound discretion and judgment of the contracting agency. Furuno U.S.A., Inc.--Recon., B-221814.2, June 10, 1986, 86-1 CPD ¶ 540. Although GSA extended Price Waterhouse the courtesy of expressing its views on the remedy, and although it may have been in the protester's interests to do so, the protester was not responsible for implementing the remedy and may not be reimbursed for such efforts, which were unrelated to the pursuit of its protest. See KPMG Peat Marwick--Entitlement to Costs, B-251902.2, June 8, 1993, 93-1 CPD ¶ 443.

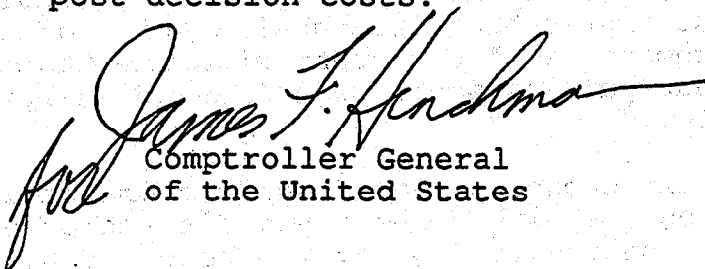
⁸Specifically, the protester's in-house counsel billed 17 hours, or \$2,470.10; the protester's senior outside counsel billed 22.55 hours, or \$7,892.50; and the protester's junior outside counsel billed 2.25 hours, or \$472.50. In addition, GSA argues that an additional \$263.23 for post-decision disbursements should be disallowed, which Price Waterhouse does not contest.

GSA next requests that we disallow \$2,405.45 for costs incurred by the protester's attorneys in complying with our protective order after the decision was issued. We decline to do so. The protester's attorneys incurred these costs returning protected documents in accordance with our protective order and responding to GSA's unsupported allegation that they had violated the protective order. Since such costs relate to the administration of our protective order, they are reimbursable. See Fritz Co., Inc.--Claim for Costs, supra.

Finally, Price Waterhouse billed 1.8 hours, or \$630, in preparing an agency-level claim for costs. A protester may not recover the costs incurred in pursuing its claim before the contracting agency. See 4 C.F.R. § 21.6(f)(2); Manekin Corp.--Claim for Costs, B-249040.2, Dec. 12, 1994, 94-2 CPD ¶ 237.

CONCLUSION

The protester should recover \$100,861.73 in bid protest costs. Of Price Waterhouse's claimed bid protest costs of \$117,506.64, we recommend that the agency not pay \$5,448.75 for filing and pursuing a clearly severable, unsuccessful protest allegation; \$472.23 for attorneys' fees shown to be excessive; \$2,714.60 for costs related to settlement discussions with the agency; and \$8,009.33 for unallowable post-decision costs.


Comptroller General
of the United States



Washington, D.C. 20548

Decision

Matter of: Aetna Government Health Plans, Inc.;
Foundation Health Federal Services, Inc.

File: B-254397.15; B-254397.16; B-254397.17;
B-254397.18; B-254397.19

Date: July 27, 1995

Thomas L. Patten, Esq., Roger S. Goldman, Esq., David R. Hazelton, Esq., Penelope A. Kilburn, Esq., Katherine A. Lauer, Esq., and Annalisa Pizzarello, Esq., Latham & Watkins, for Aetna Government Health Plans, Inc.; Thomas P. Humphrey, Esq., Robert M. Halperin, Esq., Kathryn D. Kirmayer, Esq., Stephanie V. Corrao, Esq., and Nabil W. Istafanous, Esq., Crowell & Moring, for Foundation Health Federal Services, Inc., the protesters.
Richard S. Ewing, Esq., Steven G. Reade, Esq., David S. Eggert, Esq., March Coleman, Esq., Rosemary Maxwell, Esq., Lisa B. Horowitz, Esq., Ellen T. Noteware, Esq., and Stacy J. Pollock, Esq., Arnold & Porter, for QualMed, Inc., an interested party.
Karl E. Hansen, Esq., and Laurel C. Gillespie, Esq., Office of the Civilian Health and Medical Program of the Uniformed Services, for the agency.
Daniel I. Gordon, Esq., and Paul Lieberman, Esq., Office of the General Counsel, GAO, participated in the preparation of the decision.

DIGEST

1. Significant organizational conflict of interest exists where an affiliate of one offeror's major subcontractor evaluates proposals for the procuring agency.
2. Agency acted unreasonably in assessing the significance of an organizational conflict of interest where it failed to make an independent effort to gather relevant facts, and instead relied on a document which was prepared by the two private firms whose affiliation created the conflict of interest and which presented the facts in a manner that understated the significance of the conflict.
3. In the circumstances of the organizational conflict of interest at issue, severance of communication between the two affiliates and the absence of direct financial interest by employees of the affiliate performing the evaluation of proposals did not adequately mitigate the conflict.

PUBLISHED DECISION

74 Comp. Gen. _____

DECISION

Aetna Government Health Plans, Inc. and Foundation Health Federal Services, Inc. protest the award of a contract by the Office of the Civilian Health and Medical Program of the Uniformed Services to QualMed, Inc. under request for proposals (RFP) No. MDA906-91-R-0002.¹ Aetna and Foundation contend that the award was improper due to an organizational conflict of interest involving Lewin-VHI, Inc., the consulting firm which assisted OCHAMPUS in many aspects of the procurement, including the evaluation of proposals. The alleged conflict of interest arose because QualMed proposed using an affiliate of Lewin-VHI to perform a significant portion of the services under a subcontract valued at approximately \$183 million. According to the protesters, the agency failed to take reasonable steps to avoid, neutralize, or mitigate the resulting organizational conflict of interest.

We sustain the protests.

The RFP sought proposals to provide managed health care and associated administrative services in the states of California and Hawaii for CHAMPUS beneficiaries, who include military service retirees, their dependents, and dependents of active duty members. The RFP covers a base period with five 1-year options. The estimated value of the contract is more than \$2.5 billion.

THE 1993 DECISION OF OUR OFFICE

After the agency initially made award to Aetna in July 1993, our Office sustained protests filed by Foundation and QualMed. Foundation Health Fed. Servs., Inc.; QualMed, Inc., B-254397.4 et al., Dec. 20, 1993, 94-1 CPD ¶ 3. We sustained the protests because we found that OCHAMPUS, by failing to meaningfully consider the cost impact of the offerors' proposals to manage health care, had deviated from the evaluation criteria in the solicitation.

As discussed in our prior decision, a team of approximately five employees of the consulting firm of Lewin-VHI, headed by a senior vice president of Lewin-VHI, played a major role in the procurement. In addition to helping draft key parts of the RFP, the Lewin-VHI personnel largely supplanted the business proposal evaluation team (BPET) both in the

¹The program is referred to as CHAMPUS and the agency as OCHAMPUS.

evaluation of cost proposals and in the conduct of significant portions of the discussions with offerors.²

In our decision, we found that the agency evaluators abdicated their responsibilities by adopting Lewin-VHI's judgment without meaningful review. Thus, Lewin-VHI personnel created the methodology for evaluating cost proposals and set forth that methodology in a memorandum sent to agency personnel. Among other things, that memorandum advised the agency that Lewin-VHI proposed to assume that all offerors would incur the same health care costs (at the level calculated by Lewin-VHI as the independent government cost estimate (IGCE)), notwithstanding the offerors' differing technical approaches. OCHAMPUS employees never responded to the memorandum, either to adopt or reject it. Lewin-VHI treated the agency's failure to respond to the memorandum as consent and employed the proposed methodology in the evaluation of cost proposals. Our decision noted that, even at the time of the hearing conducted by our Office, OCHAMPUS personnel, including the source selection authority (SSA), did not appear to realize that Lewin-VHI had substituted its own IGCE figures for the estimates of health care costs proposed by the offerors.

In sustaining the protest, we recommended that OCHAMPUS either revise the solicitation to accurately advise offerors of the way that technical and cost proposals would be evaluated, or reopen discussions with the offerors and request revised proposals before proceeding with the source selection. OCHAMPUS implemented our recommendation by substantially revising the RFP as well as the internal methodology for evaluating proposals.³ See QualMed, Inc., B-254397.13; B-257184, July 20, 1994, 94-2 CPD ¶ 33.

BACKGROUND OF THE CONFLICT OF INTEREST ALLEGATIONS

The agency's handling of the alleged organizational conflict of interest at issue in this protest was significantly affected by the resolution in 1992 of another organizational conflict of interest. For that reason, we set out in some

²We noted in our decision that the "core of the evaluation of business proposals" was performed by Lewin and that the BPET "for the most part simply adopted Lewin's analysis."

³Our recommendation did not address the agency's dependence on Lewin-VHI, and OCHAMPUS did not reduce its reliance on the consulting firm as a result of our decision. Lewin-VHI, in fact, played a key role in the revisions to the RFP and to internal procedures adopted to implement the recommendation in our decision.

detail the specifics of the 1992 issue, before turning to the conflict of interest directly relevant here.

The 1992 Conflict of Interest and Its Resolution

In late October 1992, the Lewin senior vice president wrote to Mr. Richard Hogue, who played a role in administering Lewin's contract with OCHAMPUS and is the contracting officer for the California/Hawaii procurement, that Lewin (then known as Lewin-ICF) was probably going to be acquired by Value Health, Inc. (VHI). The letter noted that, in its proposal for the California/Hawaii procurement, Foundation was proposing another subsidiary of VHI, Value Health Sciences, Inc. (VHS), as a supplier of proprietary software and related services. The letter explained that VHS and Lewin-VHI would remain separate corporations with independent management, and Lewin-VHI proposed to implement procedures to ensure that no sensitive information would be disclosed to VHI or VHS. The letter emphasized that VHS' portion of Foundation's proposal was "very small" and estimated that it represented six hundredths of 1 percent of Foundation's total price.⁴

At a meeting held on November 10, 1992, the agency concluded that the situation created an organizational conflict of interest. On that day, agency counsel and the contracting officer had a conversation with the Lewin senior vice president in which the agency personnel indicated that there was no action that Lewin could take (other than preventing the acquisition by VHI) which the agency would consider adequate to resolve the conflict of interest. Accordingly, in a November 12 letter, the agency formally advised Lewin that it could not continue its work as a consultant to the agency in this procurement. The agency's letter stated that the contracting officer and legal counsel had reviewed the provisions of Federal Acquisition Regulation (FAR) subpart 9.5 regarding organizational conflict of interest. The letter concluded that:

"After careful review of the information you provided and the pertinent laws and regulations, it is our position that Lewin-ICF would be unable to render impartial assistance or advice to the agency because they may be providing assistance or advice that could be detrimental to Value Health, Inc., Value Health Sciences, Inc., and Lewin-ICF. Because of the new business relationship, Lewin-ICF may be inclined to provide assistance or advice to the agency that may not be in the best

⁴On that basis, the estimated revenue to VHS would have been less than three million dollars over approximately 5 years.

interests of the Government but would be beneficial to themselves. . . . [T]he plan devised by Lewin-ICF to isolate the parent company and the other subsidiary does not negate the conflict. It does not overcome the appearance of unfair competitive advantage."

On November 30, representatives of the firms concerned and Value Health's outside counsel met with OCHAMPUS officials to discuss the organizational conflict of interest.⁵ The agency officials indicated that their primary concern was the possibility of bias arising from a financial interest (through profit sharing, compensation schemes, or bonus plans) on the part of individuals employed by the VHI affiliates. The agency agreed to allow Value Health's counsel to submit a proposed plan on December 7 to address those concerns.

That plan (entitled "Organizational Conflict of Interest Identification, Avoidance and Mitigation Plan" and referred to here as the 1992 plan), annotated with citations and notes concerning decisions of our Office, was presented as an agreement between VHS and Lewin-VHI, to be reviewed and approved by OCHAMPUS. The 7-page document contained representations regarding past and present facts, together with assertions that those facts demonstrated that no significant conflict of interest existed, and commitments to take certain steps to mitigate such a conflict, if it did exist.⁶

⁵We use the term "Value Health" to refer collectively to the affiliated companies. The law firm representing Value Health in the resolution of the 1992 and 1994 conflict of interest issues has not participated in the instant protests. Due to the affiliated companies' central role in the matters at issue, our Office permitted Value Health to participate in the protest proceedings, notwithstanding the fact that none of the Value Health entities is an interested party under our Regulations. See 4 C.F.R. §§ 21.0(b), 21.3(1) (1995). Accordingly, attorneys from the firm representing Value Health in these protests were admitted to the protective order issued in the protests, participated in the hearing, and filed pre-hearing and post-hearing submissions.

⁶Among the representations, the document stated that Lewin and VHS had not been affiliated prior to the sale of Lewin to VHI and had not shared directors, officers, or employees. The document further represented that the revenues which VHS expected to have through the Foundation contract would constitute less than specified percentages of VHI's and VHS' (continued...)

The agency's counsel determined that the plan adequately resolved the organizational conflict of interest issue, and the contracting officer so notified Lewin-VHI and Foundation in separate letters, both dated December 16. The agency's need for Lewin-VHI to continue to provide assistance in the procurement appears to have been a significant factor in the agency's decision to approve the plan.

In the December 16 letter to Lewin-VHI, the agency stated that all of Lewin-VHI's services involving the procurement:

"will, when feasible, be on a 'blind' basis; that the Office of CHAMPUS and/or [the Office of the Assistant Secretary of Defense for] Health Affairs employees will subject Lewin-VHI's work to close scrutiny in a manner determined by the agency; . . . will review all work product prepared by Lewin-VHI; . . . will perform final review and clearance of all work product prior to its use; and . . . will review the data against Lewin-VHI's interpretation to ensure that it is sound."

It appears, however, that no part of the evaluation of Foundation's proposal was actually conducted on a "blind" basis, and there is no evidence that OCHAMPUS (or Health Affairs) subjected Lewin-VHI's work to close scrutiny. The 1992 plan effectively expired in July 1993, when OCHAMPUS awarded the initial contract to Aetna, since Foundation did not propose use of VHS' software in the reprocurement.

The 1994 Conflict of Interest and Its Resolution

After amending the RFP as part of its implementation of our December 1993 decision, OCHAMPUS requested revised proposals, which were due on April 4, 1994. Less than

⁶(...continued)

projected 1994 revenue. The plan committed the subsidiaries to establishing an "ethical barrier" barring contact and communication between VHS employees and the Lewin-VHI employees serving as procurement officials.

Lewin-VHI agreed in the plan to cooperate with OCHAMPUS in adopting additional measures to "ensure that neither actual bias nor the appearance of bias enter into any of the work that it does for OCHAMPUS." Among the techniques that the plan stated Lewin-VHI was willing to adopt, if practicable and if requested by the agency, were (1) performing services on a "blind" basis (that is, without Lewin-VHI knowing the identify of the offeror), (2) having OCHAMPUS employees subject Lewin-VHI's work to close scrutiny, and (3) having another contractor review Lewin-VHI's work.

4 weeks before the closing date, QualMed initiated negotiations with Value Behavioral Health, Inc. (VBH), a provider of managed mental health care, concerning the possibility of VBH serving as a subcontractor managing mental health services, including services related to substance abuse. Like Lewin-VHI, VBH is a wholly owned subsidiary of VHI, a fact of which QualMed was aware. Both QualMed and VBH were also aware that VBH's proposed role as a subcontractor to QualMed raised an organizational conflict of interest issue.

When the outside counsel who had prepared Value Health's 1992 plan learned of the proposed subcontracting arrangement, he suggested that the 1992 plan could serve as a model for resolving this situation. Accordingly, in the course of March, he sent a revision of the 1992 plan to the Lewin-VHI senior vice president, individuals at VBH and VHI, and agency counsel responsible for the California/Hawaii procurement (who had also played the key role in approval of the 1992 plan).

On March 10, the Lewin-VHI senior vice president discussed VBH's potential participation as the mental health care subcontractor for QualMed with a senior OCHAMPUS official who was not directly involved in this procurement. Because of that official's familiarity with the CHAMPUS program, he recognized that, unlike the de minimis role of VHS' software in Foundation's proposal in 1992, VBH's proposed responsibility for managing mental health care in this procurement represented a significant share of the contract. He offered a suggestion that Lewin-VHI might be able to mitigate the conflict of interest by refraining from evaluating mental health care utilization management (apparently because he viewed that portion of the mental health care proposals as the most subjective part). That informal suggestion was included in Value Health's 1994 plan as an additional technique that could be adopted to avoid "actual bias" and "the appearance of bias." Other than the reference to this measure in Value Health's 1994 plan, there is no contemporaneous (that is, pre-protest) document indicating any guidance or instruction from OCHAMPUS restricting Lewin-VHI's role in the evaluation of proposals.

Because agency counsel had been away from the office, he did not speak with Value Health's counsel or review the plan until March 29. The next day, he left Value Health's counsel a message stating that QualMed could team with VBH and that someone other than Lewin-VHI would be found to evaluate mental health care. For purposes of QualMed and Value Health--that is, for all practical purposes--that

message effectively constituted approval of Value Health's 1994 plan.⁷

Agency counsel states (through a declaration submitted during the protest proceedings) that his primary concerns before approving Value Health's 1994 plan were the prevention of procurement information passing between Lewin-VHI and VBH and the preclusion of any financial incentive that could cause bias on the part of the Lewin-VHI employees who were assisting the agency with the evaluation. Because he concluded that Value Health's plan adequately addressed those concerns and because he trusted the Value Health affiliates and their outside counsel, he found the plan satisfactory without taking any steps to confirm the accuracy or completeness of the representations made in the plan. He made no suggestions for revisions to the plan,⁸ and apparently did not discuss the plan with anyone else at OCHAMPUS before approving it.

During discussions in May, QualMed asked the agency for guidance about resolution of the potential organizational conflict of interest. QualMed indicated that it could submit a proposal without VBH's participation, if the Lewin-VHI affiliate's involvement posed a problem for OCHAMPUS. Agency counsel and the contracting officer responded that the agency had experience in this area, and that, so long as QualMed submitted an acceptable plan for mitigation of the conflict, the agency would approve it and VBH could serve as QualMed's subcontractor.

⁷Agency counsel states that he further reviewed the plan during April, and confirmed to Value Health's outside counsel by telephone on April 26 that he (agency counsel) had no comments or revisions to suggest and that Lewin-VHI and VBH should proceed to execute the plan.

Agency counsel's approval of Value Health's plan in March and April indicates that the contracting officer was not involved in the review and approval of the plan. Indeed, the contracting officer apparently did not learn of the existence of the Lewin-VBH conflict of interest issue until April 1994 and did not see the 1994 plan until some time after May.

⁸The one exception was that he suggested that the plan apply to the managed care procurement covering Washington and Oregon as well; for reasons not relevant here, this revision was not adopted. Other than this non-substantive suggestion, which was in any event rejected, there appears to be no support in the record for the statement in the agency report that "OCHAMPUS reviewed and revised the proposed [1994] plan." (Emphasis added.)

On June 1, Value Health's counsel formally transmitted to agency counsel a copy of the 1994 plan, signed by the Lewin-VHI senior vice president and a representative of VBH.⁹ The OCHAMPUS attorney prepared a legal opinion which, although not introduced into the record due to attorney/client privilege, evidently found the plan acceptable. Ultimately, the plan was signed by an acting contracting officer in early July; that individual had no substantive involvement in reviewing or approving the plan, and the agency has advised that she was performing a ministerial function in signing it.

The record includes no contemporaneous analysis by the contracting officer or any other official at OCHAMPUS of the conflict of interest or of a recommended course of action for avoiding, neutralizing, or mitigating it. Unlike the case with the 1992 plan, the record contains no letter from the contracting officer (or anyone else at the agency) advising QualMed or any Value Health affiliate that the 1994 plan had been approved. There is also nothing in the record comparable to the December 16, 1992, letter to Lewin-VHI instructing that firm about procedures which would be undertaken to ensure the conflict was adequately mitigated, nor is there any record of agency consideration of any such procedures.

THE EVALUATION OF PROPOSALS AND SELECTION OF QUALMED .

Proposals were submitted at the beginning of April 1994 and evaluated during the ensuing 4 weeks. In its proposal, QualMed wrote about its subcontractor's affiliate in the following terms:

"Lewin-VHI . . . is assisting VHI and its subsidiaries in maintaining an active role in the health care reforms anticipated under the Clinton administration. A key health policy consultant and an effective voice in Washington, . . . Lewin-VHI staff members have substantial experience performing analysis of DoD health policies and programs."

During the evaluation of the mental health portion of proposals, Lewin-VHI personnel did not score the proposals' mental health care utilization management trend factors; that scoring was left to a second consulting firm assisting OCHAMPUS in the cost evaluation. Lewin-VHI personnel did

⁹Although the record does not include a copy of the draft reviewed by agency counsel in March, none of the parties has indicated that the June 1 signed plan differed in any way from that draft.

score the proposals, including VBH's, for other mental health trend factors. Lewin-VHI personnel also participated in meetings (held in Lewin-VHI's offices) to discuss all aspects of mental health care proposals, including the scores for the utilization management trend factor. At those meetings, Lewin-VHI personnel acted as "devil's advocates," challenging the rationale for the scores that the other consultant had assigned (including the scores for VBH's proposal). Those meetings resulted in changes to the proposals' scores.

Written and oral discussions were conducted between mid-May and early July. Lewin-VHI played a prominent role in the portion of the discussions involving cost proposals, including the discussion of mental health care proposals. Best and final offers (BAFO) were due on August 8. Discussions were held with the offerors during September and early October, and a second round of BAFOs was due on October 24. In the evaluation of the second round of BAFOs, Lewin-VHI's role remained unchanged, except that Lewin-VHI personnel refrained from performing the initial scoring of one additional mental health care trend factor (provider discounts). The record indicates that the other consultant met with Lewin-VHI personnel during September to discuss QualMed/VBH's proposal.

In late November, a decision was made (for reasons not relevant here) to change one aspect of the requirements, which necessitated an amendment to the RFP. In response to the RFP amendment, discussions were held with offerors during December and January, and a third round of BAFOs was due on February 13, 1995. In the evaluation of those final BAFOs, Lewin-VHI personnel continued to participate in the evaluation of mental health care proposals, including VBH's.

The technical evaluators assigned the highest technical score to Aetna's proposal; Foundation's score was second; and QualMed's was third. The BPET (based largely on Lewin-VHI's analysis) concluded that Aetna's proposal would probably cost the government substantially more than Foundation's or QualMed's. The latter two proposals were found to represent similar probable costs to the government (both well over \$2.5 billion), with QualMed's approximately \$50 million lower. Using its formula for the cost/technical tradeoff (referred to as a "best buy" analysis), the source selection advisory council (SSAC) found that Foundation and QualMed were significantly ahead of the other offerors, with Foundation slightly ahead of QualMed (by less than two tenths of 1 percent).¹⁰

¹⁰The RFP assigned the technical proposal 50 percent more weight than cost (that is, the weighting was 60/40).

The SSAC and the SSA viewed this situation as essentially a tie between Foundation and QualMed. Based on several factors which the SSA and the SSAC viewed as indications that QualMed's proposal represented a better value than Foundation's, the SSAC recommended, and the SSA selected, QualMed for award, which was made on March 31. Selection of QualMed's proposal to a significant degree reflected Lewin-VHI's judgment, which was that Foundation's proposal was essentially less persuasive than QualMed's with regard to proposed trend factors and probable cost.

In a press release issued on April 3, VHI announced that its subsidiary, VBH, had won a \$200 million subcontract to provide mental health and substance abuse services. The press release stated that the subcontract was expected to produce \$38 million in revenue to VBH in the first program year.

PROTEST ALLEGATIONS

Aetna and Foundation allege that the agency failed to take reasonable steps to avoid or mitigate the organizational conflict of interest involving Lewin-VHI and VBH. The protesters also assert that the actions of QualMed and VBH warrant termination of the contract to QualMed.

In addition, both Foundation and Aetna assert that various aspects of the technical and cost evaluations were unreasonable or inconsistent with the solicitation. Foundation further protests as unreasonable the agency's decision to award the contract to QualMed notwithstanding the "best buy" analysis, under which Foundation's proposal was in line for award. Foundation also contends that the agency improperly permitted a former OCHAMPUS employee to play a major role in the preparation of QualMed's proposal, despite the agency's knowledge that the individual had been an on-site representative for the Department of Defense at Foundation's site when Foundation was performing under a predecessor contract. Aetna also contends that the agency misled the firm during discussions and failed to investigate an anonymous informant's report that information proprietary to Aetna had been improperly released.

Because we view the organizational conflict of interest as dispositive, we devote this decision primarily to that issue and address the other protest grounds only briefly.

DISCUSSION

Overview of the Rules Governing Organizational Conflicts of Interest

FAR subpart 9.5 sets forth the regulatory guidance governing organizational conflicts of interest. Such a conflict of interest arises where:

"because of other activities or relationships with other persons, a person is unable or potentially unable to render impartial assistance or advice to the government, or the person's objectivity in performing the contract work is or might be otherwise impaired, or a person has an unfair competitive advantage."

FAR § 9.501. Contracting officials are to avoid, neutralize or mitigate potential significant conflicts of interest so as to prevent unfair competitive advantage or the existence of conflicting roles that might impair a contractor's objectivity. FAR §§ 9.504(a), 9.505.

The responsibility for determining whether an actual or apparent conflict of interest will arise, and to what extent the firm should be excluded from the competition, rests with the contracting agency. SRS Technologies, B-258170.3, Feb. 21, 1995, 95-1 CPD ¶ 95. Because conflicts may arise in factual situations not expressly described in the relevant FAR sections, the regulation advises contracting officers to examine each situation individually and to exercise "common sense, good judgment, and sound discretion" in assessing whether a significant potential conflict exists and in developing an appropriate way to resolve it. FAR § 9.505. We will not overturn the agency's determination except where it is shown to be unreasonable. D.K. Shifflet & Assocs., Ltd., B-234251, May 2, 1989, 89-1 CPD ¶ 419.

The Three Types of Organizational Conflict of Interest Addressed in FAR Subpart 9.5

The situations in which organizational conflicts of interest arise, as addressed in FAR subpart 9.5 and the decisions of our Office, can be broadly categorized into three groups. The first group consists of situations in which a firm has access to nonpublic information as part of its performance of a government contract and where that information may provide the firm a competitive advantage in a later competition for a government contract. FAR § 9.505-4. In these "unequal access to information" cases, the concern is limited to the risk of the firm gaining a competitive advantage; there is no issue of bias.

The second group consists of situations in which a firm, as part of its performance of a government contract, has in some sense set the ground rules for another government contract by, for example, writing the statement of work or the specifications. In these "biased ground rules" cases, the primary concern is that the firm could skew the competition, whether intentionally or not, in favor of itself. FAR §§ 9.505-1, 9.505-2. These situations may also involve a concern that the firm, by virtue of its special knowledge of the agency's future requirements, would have an unfair advantage in the competition for those requirements. The Pragma Corp., B-255236 et al., Feb. 18, 1994, 94-1 CPD ¶ 124.

Finally, the third group comprises cases where a firm's work under one government contract could entail its evaluating itself, either through an assessment of performance under another contract or an evaluation of proposals. FAR § 9.505-3. In these "impaired objectivity" cases, the concern is that the firm's ability to render impartial advice to the government could appear to be undermined by its relationship with the entity whose work product is being evaluated. Id.; see also FAR § 9.501 (definition of organizational conflict of interest).

While FAR subpart 9.5 does not explicitly address the role of affiliates in the various types of organizational conflicts of interest, there is no basis to distinguish between a firm and its affiliates, at least where concerns about potentially biased ground rules and impaired objectivity are at issue. See ICF Inc., B-241372, Feb. 6, 1991, 91-1 CPD ¶ 124.

In the instant protests, there has been no allegation (and no evidence, direct or circumstantial) that VBH had access to relevant nonpublic information obtained through Lewin-VHI's contract with OCHAMPUS, and the "unequal access to information" type of organizational conflict of interest therefore is not at issue. Similarly, there is no indication in the record that Lewin-VHI's role in writing key parts of the solicitation in any way could have skewed the competition in favor of VBH, since the writing of the solicitation was essentially completed prior to Lewin-VHI's learning of VBH's teaming with QualMed. Accordingly, the "biased ground rules" type of conflict of interest does not arise. The protests here reflect the third type of organizational conflict of interest, involving potentially impaired objectivity, in that they concern the propriety of Lewin-VHI's evaluating proposals where that evaluation could determine whether its affiliate would receive a \$183 million subcontract.

The Factual Representations in the 1994 Plan and The Agency's Response

The protesters contend that Value Health's 1994 plan presented the facts in such a way as to fail to alert OCHAMPUS to the significance of the organizational conflict of interest. We agree. The 1994 plan was incomplete and inaccurate in describing the facts relevant to the organizational conflict of interest. For example, the plan failed to mention that VBH's subcontract would be on the order of \$183 million of managed health care services, more than 50 times larger, in dollar terms, and far more central to the procurement than the de minimis amount of software and services that was to be purchased from VHS under the 1992 plan.

The plan also substantially reduced the apparent significance of the subcontract, and therefore the conflict of interest, by disclosing only the percentage of VBH's and VHI's total earnings that the subcontract would represent (rather than the percentage of total revenue, as in Value Health's 1992 plan). Value Health contends that earnings are a more meaningful criterion than revenue for VBH's subcontract because much of the revenue consists of "passthrough" payments to medical service providers (that is, VBH merely forwards those payments to the doctors or other providers, and does not retain any portion of the funds transmitted). While Value Health views the revenue figures (both in dollar and percentage terms) as overstating the true value of the subcontract to VBH, Value Health's own press release announcing the award disclosed only the amount of revenue involved, without reference to earnings. The effect of not disclosing the dollar figures or the impact on revenue, as was done in 1992, was plainly to minimize the significance of the conflict. While objective reasons may be presented for citing the earnings figure, the failure to provide information comparable to that disclosed in 1992 was at least potentially misleading.

With respect to the corporate affiliation between VBH and Lewin-VHI, the 1994 plan added a representation not made in the 1992 version: it stated affirmatively that "Lewin and VBH . . . do not share officers or employees"; in fact, the two corporations have the same corporate secretary. On the other hand, the 1994 plan deleted the reference in the 1992 plan to the absence of common directors in the two corporations. Three of the four members of the boards of directors of Lewin-VHI and VBH are the same.¹¹

¹¹Value Health devoted considerable time during the protests arguing that the corporate secretary's role at Lewin-VHI was
(continued...)

In sum, Value Health provided OCHAMPUS with a document that purported to describe a factual situation, and, in light of Lewin-VHI's historical role at OCHAMPUS, Value Health could reasonably anticipate that OCHAMPUS would rely on the document as a presentation of the relevant facts of that situation. Based on our review of the entire record, we conclude that the 1994 plan presented the facts in such a way as to fail to alert OCHAMPUS to the scope and significance of the organizational conflict of interest.

As to OCHAMPUS, the agency failed to take reasonable steps to learn the relevant facts about the organizational conflict of interest. FAR § 9.505 directs the contracting agency, and in particular the contracting officer, to examine each individual potential organizational conflict of interest situation "on the basis of its particular facts," and that direction cannot be fulfilled if the agency has not ensured that it is aware of the relevant facts. Here, OCHAMPUS made no inquiry beyond the four corners of Value Health's own partisan presentation of the facts in its 1994 plan.¹²

Essentially, OCHAMPUS left the gathering of relevant facts and, indeed, the resolution of the conflict of interest here to Lewin-VHI and VBH, just as the evaluation of cost proposals had been left, by default, to Lewin-VHI. Although there is no evidence of intent to misrepresent the facts, Value Health presented OCHAMPUS with a plan which was incomplete and inaccurate, thereby understating the significance of the conflict of interest. In our view, allowing the private firm whose conflict of interest is at issue to decide how to describe and resolve that conflict is

¹¹(...continued)

inconsequential and that the boards of directors of Lewin-VHI and VBH rarely, if ever, meet. In our view, such arguments miss the point, which is that Value Health failed to present clearly relevant facts in a document that purported to identify the organizational conflict of interest.

¹²Based on the testimony of the agency witnesses at the hearing held in this protest, we find it unlikely that anyone at OCHAMPUS was aware of the differences noted above between the 1992 and 1994 plans prior to the filing of these protests. It would have been difficult, without performing a side-by-side comparison, to detect the deleted reference to the absence of common directors or the shift from percentage of revenue to percentage of earnings to describe the importance of the Value Health affiliate's involvement. It appears that no one, including agency counsel, performed such a comparison.

unreasonable on its face, regardless of the capabilities and integrity of that firm and its employees.

The Adequacy of the Safeguards in the 1994 Plan

The agency views the provisions of the 1994 plan as adequately resolving Lewin-VHI's conflict of interest, and argues that a more complete presentation of the facts would not have mattered. For OCHAMPUS, essentially the only significant fact was the isolation of the Lewin-VHI employees working for OCHAMPUS in terms of both communication and personal remuneration.¹³ This view reflects a misunderstanding of the nature of the conflict. While a "Chinese wall" arrangement may resolve an "unfair access to information" conflict of interest, it is virtually irrelevant to an organizational conflict of interest involving potentially impaired objectivity. See ICF Inc., supra, at 3.

The walling off of Lewin-VHI's employees may have effectively ensured that they did not release nonpublic information to VBH or QualMed and that no pressure was placed on them to favor VBH or QualMed. Similarly, the absence of any explicit link between VBH's winning the subcontract and those employees' compensation may have precluded their having a direct financial interest in the outcome of the competition. Organizational conflicts of interest, however, arise "because of other activities or relationships with other persons," and they pertain to the organization (including, as discussed earlier, its affiliates), quite apart from the financial interests of individuals. FAR § 9.501. At issue, after all, is an organizational, not an individual, conflict of interest. Accordingly, the agency had no reasonable basis to conclude that, due to the absence of financial or other pressure on the individual Lewin-VHI evaluators, the 1994 plan mitigated Lewin-VHI's organizational conflict of interest.¹⁴

¹³QualMed contends that, given that isolation, it would have been appropriate, under FAR subpart 9.5, to permit Lewin-VHI to evaluate VBH's proposal. OCHAMPUS appears to agree with that position: the declaration that its counsel prepared during the course of these protests describes the use of someone other than Lewin-VHI to evaluate VBH's portion of QualMed's proposal as essentially a superfluous afterthought, merely a "sensible additional precaution" added after the plan had already been found acceptable due to the isolation of the Lewin-VHI employees.

¹⁴Value Health also suggests that the Lewin-VHI employees working for OCHAMPUS on this procurement were concerned only
(continued...)

Value Health argues that the protesters' position calls for an improper per se proscription against awarding contracts to companies with potential organizational conflicts of interest. We agree that a per se approach would be inconsistent with FAR subpart 9.5, which directs the contracting officer to develop a course of action to avoid or mitigate organizational conflicts of interest, where that is possible. FAR § 9.504(e). The FAR recognizes, however, that some organizational conflicts of interest cannot be mitigated. See, e.g., FAR §§ 9.508(e), (f) (prohibition on firm competing for contract in certain circumstances).

The organizational conflict of interest presented here could not be mitigated. Our conclusion in this regard is based, not on a per se approach, but on consideration of the very substantial dollar value of the VBH subcontract, Lewin-VHI's historical role, and the largely subjective nature of the evaluation of probable health care costs in this procurement, where probable cost calculations turn on whether the Lewin-VHI evaluators have been persuaded that an offeror will succeed in managing health care as proposed. In these circumstances, the agency could not mitigate or neutralize the organizational conflict of interest created

¹⁴(...continued)

with Lewin-VHI (and then only with their subgroup within Lewin-VHI), and there were thus no dual loyalties and no possibility of impaired objectivity. Value Health points to Lewin-VHI's tradition of autonomy, the allegedly tenuous affiliation between Lewin-VHI and VBH, and the 1994 plan's prohibitions on communications between the two affiliates. We find this argument unpersuasive both legally and factually.

As a matter of law, as explained above, we see no basis to distinguish between one affiliate and another in conflict of interest situations, such as this one, involving the risk of competing loyalties. As to the facts regarding the affiliation here, in addition to their shared corporate officer and directors, these are not large corporations: when the 1994 plan was drafted, VHI and Lewin-VHI each had fewer than 150 employees, and VBH (the largest of the three in terms of the number of employees) had fewer than 2,000. Moreover, all the Value Health entities, including Lewin-VHI, cooperate in developing business. Lewin-VHI's monthly operations reports highlight that affiliate's initiatives with other VHI companies, and a recent operations report stated, "We look forward to continuing to grow this 'account' in 1995." More relevant to these protests is the fact that Lewin-VHI set its senior vice president a "marketing goal" of having his practice group work with another VHI company to market a product.

by QualMed's submitting a proposal under which VBH would receive a \$183 million subcontract.

Appearances, "Hard Facts," and Prejudice

The integrity and commitment to objectivity of the Lewin-VHI employees working for OCHAMPUS serve as the basis for three closely related arguments advocated by the parties defending the award. First, Value Health, in particular, contends that FAR subpart 9.5 does not apply to "apparent" conflicts of interest, and that a standard based on the appearance of impropriety "has no place in determining whether agencies have met their responsibilities under FAR Subpart 9.5." In our view, the organizational conflict of interest at issue in these protests was not merely an apparent conflict. Lewin-VHI's dual roles placed it in an actual organizational conflict of interest because of the prospect that it would be unable to render impartial advice to OCHAMPUS. FAR § 9.501. Furthermore, we view it as axiomatic that a key purpose of FAR subpart 9.5 is to avoid the appearance of impropriety in government procurements.

Second, the parties defending the award contend that our case law requires "hard facts" before an offeror is excluded from a competition due to an organizational conflict of interest, and that no such facts exist here. It is true that a determination to exclude an offeror must be based on hard facts, rather than mere suspicion. Clement Int'l Corp., B-255304.2, Apr. 5, 1994, 94-1 CPD ¶ 228; see also CACI, Inc.--Fed. v. United States, 719 F.2d 1567 (Fed. Cir. 1983). The facts that are required, however, are those which establish the existence of the organizational conflict of interest, not the specific impact of that conflict.¹⁵ Once the facts establishing the existence of an organizational conflict of interest are present, reasonable steps to avoid, mitigate, or neutralize the conflict are required without further need for "hard facts" to prove the conflict's impact on the competition. Where, as here, the facts demonstrate that an organizational conflict of interest exists, the harm from that conflict, unless it is avoided or adequately mitigated, is presumed to occur.¹⁶

¹⁵Thus, in Clement Int'l, supra, we denied the protest because, other than the protester's unsupported allegations, nothing in the record suggested that the awardee had access to relevant, nonpublic information, or that the awardee had played any role in preparing the solicitation or specifications.

¹⁶For example, an unfair competitive advantage is presumed to arise where an offeror possesses relevant nonpublic

(continued...)

The third argument concerns our Office's requirement that at least a reasonable possibility of prejudice be shown before a protest is sustained. Because the Lewin-VHI evaluators did not leak information, did not skew the ground rules, and were not biased in their evaluation, the parties defending the award contend that the protesters were not prejudiced by the way the conflict of interest issue was resolved.

This contention fails for the same reason as the "hard facts" argument. There is a presumption of prejudice to competing offerors where an organizational conflict of interest (other than a de minimis matter) is not resolved. Organizational conflicts of interest call into question the integrity of the competitive procurement process, and, as with other such circumstances, no specific prejudice need be shown to warrant corrective action. See, e.g., NKF Eng'g, Inc. v. United States, 805 F.2d 372, 376 (Fed. Cir. 1986); Compliance Corp. v. United States, 22 Cl. Ct. 193 (1990), aff'd, 960 F.2d 157 (Fed. Cir. 1992). For that reason, we have sustained a protest where the awardee obtained its competitor's information improperly, even though that information may not have given the awardee a competitive advantage. Litton Sys., Inc., 68 Comp. Gen. 422 (1989), 89-1 CPD ¶ 450.

Moreover, where the integrity of the system is at issue, the honesty and good faith of the individual actors cannot render behavior permissible where it would otherwise be improper.¹⁷ For this reason, an agency's confidence in a individual contractor's probity cannot eliminate or mitigate what would otherwise be an organizational conflict of interest. Accordingly, we conclude that, notwithstanding the integrity of the Lewin-VHI evaluators and the absence of evidence of actual bias on their part, the appearance of impropriety resulting from the significant organizational

¹⁶(...continued)

information that would assist that offeror in obtaining the contract, without the need for an inquiry as to whether that information was, actually, of assistance to the offeror. See FAR § 9.505(b)(2); see also GIC Agricultural Group, 72 Comp. Gen. 14 (1992), 92-2 CPD ¶ 263.

¹⁷Thus, it is generally improper for a government employee to accept a gratuity from a firm seeking to obtain a contract from the employee's agency, regardless of the honesty of the employee or the absence of a quid pro quo. See FAR § 3.101-2.

conflict of interest present here rendered the award to QualMed and VBH improper.¹⁸

REMAINING PROTEST GROUNDS

We find no factual basis for Aetna's allegation that OCHAMPUS misled it during discussions regarding the application of revised reimbursement provisions (set forth in an amendment to the RFP) to capitated arrangements. According to Aetna, it advised the agency during discussions on May 23, 1994, that the revision created an inconsistency in the RFP about the way capitated arrangements would be viewed, and OCHAMPUS agreed to review the matter and respond to Aetna. The agency never gave Aetna further guidance in this area, however, and Aetna did not raise it again during subsequent discussions. Aetna now states that it was left with "the clear understanding" that the revised RFP in effect precluded capitated arrangements, which placed Aetna at a competitive disadvantage in the face of other offerors who proposed such arrangements. We have reviewed the transcript of the May 1994 discussions and see no basis to conclude that OCHAMPUS misled Aetna into believing that capitated arrangements were effectively barred, or otherwise gave Aetna misleading guidance.¹⁹

With respect to Aetna's allegation that the agency failed to adequately investigate an informant's statement that Aetna's proprietary information had been improperly released, nothing in the record relevant to this matter would warrant sustaining this protest ground. The agency received an anonymous message that Aetna's proprietary information had

¹⁸The agency, QualMed, and Value Health suggest that, if our Office finds that Lewin-VHI's conflicting roles constitute a significant conflict of interest not mitigated by the 1994 plan, OCHAMPUS should be given the opportunity to obtain a waiver. See FAR § 9.503. While the propriety of a waiver is not before us, on the current record there appears to be no overriding governmental interest weighing in favor of setting the conflict of interest rules aside in a procurement of this magnitude and importance. See Lawlor Corp.--Recon., 70 Comp. Gen. 374 (1991), 91-1 CPD ¶ 335.

¹⁹At most, the record suggests that the agency failed to provide the specific guidance that Aetna requested. To the extent that Aetna believed that the RFP amendment at issue, combined with the agency's failure to resolve the inconsistency that Aetna perceived, created a deficiency in the solicitation, it was required to raise that issue in a protest filed prior to the next closing date for the receipt of revised proposals. 4 C.F.R. § 21.2(a)(1).

been leaked or stolen, with neither details about which procurement might be involved nor corroborating evidence. Even if we assume, arguendo, that Aetna is correct in arguing that the agency was required to pursue its investigation further, neither Aetna's efforts nor the protest proceedings have uncovered any indication of an impropriety that could call into question the award to QualMed or the recommendation set out below.

In light of our recommendation, we do not reach the protest grounds which relate solely to the evaluation or selection of QualMed's proposal. Of the remaining protest grounds asserted by Aetna, we find no merit to any which could affect our recommendation. In particular, there is no merit to Aetna's argument that Lewin-VHI's conflict suggests bias in the drafting of the solicitation, since the conflict did not arise until after the solicitation had been drafted. We similarly see no logical or factual basis for Aetna's contention that Lewin-VHI's conflict might have led it to favor Foundation over Aetna.

CONCLUSION AND RECOMMENDATION

Because the agency failed to recognize the significance of the organizational conflict of interest and failed to take reasonable steps to avoid or mitigate it, we sustain the protests. With respect to the appropriate recommendation, the agency urges us not to recommend termination of the award to QualMed, even if we sustain the protest. OCHAMPUS and QualMed argue in this regard that there is no basis to disqualify QualMed, even if the agency's actions were improper.²⁰ QualMed, in particular, contends that its actions were reasonable and cannot fairly be criticized.

The agency and awardee also point to the criteria which our Bid Protest Regulations state are to be considered in determining the appropriate recommendation. 4 C.F.R. § 21.6(b). Those criteria include the seriousness of the procurement deficiency, the degree of prejudice to the interested party and to the integrity of the competitive procurement system, the good faith of the parties, cost to the government, urgency of the procurement, and the impact of the recommendation on the contracting activity's mission. Id.

We do not find that either QualMed's or Value Health's conduct was such that the award should be left undisturbed. Neither QualMed nor any of the Value Health entities took reasonable steps to ensure that the plan that purported to

²⁰QualMed specifically wants "an opportunity to submit an offer 'untainted' by the alleged conflict."

identify the conflict disclosed the relevant facts fully and correctly. QualMed left the resolution of the conflict of interest matter to VBH and Lewin-VHI; those entities left it to Value Health's outside counsel; outside counsel appears to have believed that he was leaving it to the agency; and the agency relied on Value Health. While there is no evidence that the parties acted in bad faith, we find that they failed to adequately discharge their responsibilities. See GIC Agricultural Group, supra. There is no overriding reason to allow for providing a second opportunity for the entities to act more responsibly and in compliance with the governing regulation.

The handling of Lewin-VHI's organizational conflict of interest on the part of all the parties involved constituted a serious deficiency in this procurement and one that, absent unequivocal corrective action, casts doubt on the integrity of the competitive procurement process. We are sensitive to the agency's concern about further delays in a procurement which has already been subject to significant delays, and where, due to the size of the procurement, delays lead to substantial additional costs. Taking those concerns into account, we recommend that OCHAMPUS terminate QualMed's contract for the convenience of the government and make award to Foundation, if otherwise appropriate. We note in this regard that the agency had selected Foundation's proposal as the "best buy" in any event. Its technical ratings were higher than QualMed's, under a solicitation which stated that technical factors were given substantially more weight than cost, while the two proposals' projected probable cost figures were relatively close. In light of the stay which remains in place and Aetna's continuing performance under the prior award, our recommendation should not entail any delay.

QualMed must bear responsibility for the deficiencies in the representations made to OCHAMPUS by its proposed subcontractor regarding this procurement. Cf. TeleLink Research, Inc.--Recon., B-247052.2, Sept. 28, 1992, 92-2 CPD ¶ 208 (subcontractor's alleged misrepresentation attributed to offeror). QualMed was aware of Lewin-VHI's conflict of interest at the time it proposed to team with VBH. Indeed, QualMed's proposal noted VBH's affiliation with Lewin-VHI and the latter's involvement with the Department of Defense. While QualMed could have made other arrangements for mental health care (as it confirmed to OCHAMPUS as late as May 1994), it was plainly willing to benefit from VBH's affiliation with Lewin-VHI, if it could do so. QualMed's actions do not justify delaying this procurement further in order to allow QualMed another opportunity to submit a proposal untainted by conflict of interest.

In addition, Foundation and Aetna are entitled to the costs of filing and pursuing the protest grounds which have been sustained, including reasonable attorneys' fees. 4 C.F.R. § 21.6(d)(1). The protesters should submit their certified claims for those costs directly to the agency within 60 working days of receipt of this decision. 4 C.F.R. § 21.6(f)(1).

The protests are sustained.

James T. Hinchman
for Comptroller General
of the United States

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