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**Comptroller General
of the United States**

**United States Government Accountability Office
Washington, DC 20548**

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Decision

Matter of: Marine Hydraulics International, Inc.

File: B-403386; B-403386.2

Date: November 3, 2010

Terence Murphy, Esq., Patrick H. O'Donnell, Esq., and J. Bradley Reaves, Esq., Kaufman & Canoles, for the protester.

Robert M. Tata, Esq., and Carl D. Gray, Esq., Hunton & Williams, LLP, for Earl Industries, LLC, an intervenor.

Janice M. Passo, Esq., Department of the Navy, for the agency.

Scott H. Riback, Esq., and John M. Melody, Esq., Office of the General Counsel, GAO, participated in the preparation of the decision.

DIGEST

Protest challenging agency's cost realism evaluation is sustained, where agency unreasonably made several upward adjustments to protester's proposed cost that raised protester's cost above awardee's; but for the erroneous adjustments, protester's evaluated cost would have been low.

DECISION

Marine Hydraulics International, Inc. (MH), of Norfolk, Virginia, protests the award of a contract to Earl Industries, LLC, of Portsmouth, Virginia, under request for proposals (RFP) No. N00024-08-R-4405, issued by the Department of the Navy, Naval Sea Systems Command, for executing, planning, maintenance, repair and alteration to a number of LPD 17 Class ships home ported in, and visiting, the Norfolk, Virginia area. MH maintains that the agency miscalculated proposals and made an unreasonable award decision.

We sustain the protest.

The RFP contemplated the award of a cost plus award and incentive fee, multi-ship, multi-option contract for a base year, with four 1-year options, for up to 10 ship "availabilities" (an availability is an interval of time during which a ship is made available to the contractor for performance of required work). Because the precise work during each availability is unknown in advance, the RFP included a notional

work package--as well as a listing of estimated labor hours to perform certain tasks--to which offerors were to respond with technical proposals and proposed cost/fee estimates. RFP, § L at 162-66; Agency Report (AR), exh. 2b. Award was to be made to the offeror submitting the proposal deemed to be the “best value” considering evaluated cost and several non-cost factors (not relevant here). Technical considerations were more important than cost, but the importance of cost would increase as differences in technical merit decreased. RFP at 179.

The agency received and evaluated four proposals, including those of the awardee and protester. In evaluating proposed costs, the agency developed cost estimates for each proposal for the notional work package/labor hour estimates, and then multiplied the results of that evaluation by 10 to account for the 10 availabilities contemplated by the RFP. After evaluating the proposals, the agency engaged in discussions and ultimately solicited and received two final proposal revisions (FPR). After evaluating the second FPRs, the agency assigned the following ratings to the protester’s and awardee’s proposals:

	Earl Industries	Marine Hydraulic
Overall Proposal Rating	Very Good	[deleted]
Management Approach	[deleted]	[deleted]
Technical Approach	[deleted]	[deleted]
Resource Capabilities	[deleted]	[deleted]
Past Performance	[deleted]	[deleted]
Evaluated Price	\$84,402,522	[\$deleted]

AR, exh. 25, at 2. On the basis of these evaluation results, the agency made award to Earl, finding that its proposal represented the best value to the government. After being advised of the agency’s award decision and receiving a debriefing, MH filed this protest.

DISCUSSION

The majority of MH’s arguments focus on the reasonableness of the agency’s cost evaluation of its proposal, although MH also maintains that the agency erred in evaluating it’s and Earl’s technical proposals. We have considered all of MH’s arguments and find the cost evaluation issues discussed below to have merit. Accordingly, we sustain the protest on these grounds, and find that the remainder of its assertions lack merit.

Where, as here, an agency is evaluating proposals for the award of a cost reimbursement contract, an offeror’s proposed costs are not dispositive since, regardless of the costs proposed, the government will be liable to pay the contractor its allowable and allocable costs. Federal Acquisition Regulation (FAR) §§ 15.305 (a)(1), 15.404-1(d); Frank A. Bloomer--Agency Tender Official, B-401482.2,

B-401482.3, Oct. 19, 2009, 2009 CPD ¶ 203 at 10. Consequently, an agency must perform a cost realism evaluation to determine the extent to which an offeror's proposed costs are realistic for the work to be performed. *Id.* Such an evaluation involves independently reviewing and evaluating elements of each offeror's cost (and making adjustments thereto) to determine whether the proposed cost elements are realistic for the work to be performed, reflect a clear understanding of the requirements, and are consistent with the methods of performance and materials described in the offeror's technical proposal. We will review an agency's cost realism analysis for reasonableness. *ITT Fed. Servs. Int'l Corp.*, B-289863 *et al.*, Dec. 16, 2002, 2002 CPD ¶ 216 at 2-3. We find that the agency's evaluation of MH's proposed cost was unreasonable.

Condition Report Estimates, Production Planning and Estimating, and Program Management Production Phase

MH asserts that the agency improperly calculated its probable cost to perform three aspects of the requirement relating to estimating and managing work to be accomplished under the contract. The crux of MH's argument is that the agency miscalculated the estimated number of hours per day, per availability required for this work, which resulted in the agency's arriving at a higher number of hours per day and a correspondingly higher cost. In these areas, the agency concedes that its methodology was flawed, as the protester asserts, and that it improperly added \$[deleted] to MH's evaluated cost for these three items.¹ Supp. AR, at 14-16. As the parties agree concerning the nature of the flaw in the agency's evaluation in these areas, we need not discuss them further; these aspects of the evaluation were unreasonable.

Ship's Force Parking

The protester asserts that the agency improperly increased its proposed cost to account for the cost of security guard services for ship's force parking areas; the RFP provided an estimated 3,780 hours per availability for ship's force parking. RFP at 165. In its second FPR, MH proposed a deviation from this aspect of the requirement, explaining that it recently acquired a street dividing two parcels comprising its facility. The protester states that this acquisition has enabled it to join the two parcels into one larger parcel, to place a security perimeter around the entire

¹ The parties disagree as to how the costs for these three items should have been treated in relation to MH's subcontractors and material costs, with the agency apparently conceding that it over-calculated subcontractor hours to some extent; MH claims the total for the three items was inflated by \$[deleted], and that the agency's correction is understated. Supp. AR at 14-16; Protester's Supp. Comments at 4. We need not resolve these disagreements, since, as discussed below, they would not affect our conclusion and recommendation.

facility, and to create sufficient new parking for all of the ship's force for this contract. MH's proposal concluded as follows:

[deleted]

AR, exh. 17a, at E-1. MH asserts that the agency improperly added the cost of providing 3,780 hours of security guard services per availability (as well as the cost of certain materials) to its evaluated cost.

The agency responds that the upward adjustment was reasonable because MH did not provide historical evidence showing that it had previously treated ship's force parking as an indirect, as opposed to a direct, cost. According to the agency, MH historically has charged ship's force parking as a direct cost, as evidenced by several recent contracts.

We find that the agency unreasonably added the cost of security guard services for ship's force parking to MH's proposed cost. As noted, MH's FPR unequivocally proposed to provide ship's force parking inside the fenced perimeter of MH's facility at no direct cost to the government, and fully explained the basis for this approach. In rejecting MH's approach, the agency relied solely on the fact that MH had billed this item as a direct cost under prior contracts. Given the explanation in MH's FPR, however, we think this sole reliance was unreasonable. While MH's practice under prior similar contracts might have been relevant, the FPR essentially explained why MH's prior practice was not relevant. The agency never determined that this explanation was unpersuasive or unrealistic in any way, and even now has not established that there was reason to question the basis for MH's indirect cost approach.

Further, the agency ignored the fact that MH's proposed allocation of the cost of security guard services to an indirect cost pool was entirely consistent with the accounting practices specifically approved for MH by the Defense Contract Audit Agency (DCAA).² In this regard, the record shows that every iteration of MH's proposal included a copy of the latest version of its DCAA-approved forward pricing rate agreement. AR, exh., 3, attach. C.1-2; exh. 13b, attach. Q-7-1; exh. 17, attach. FPR2; see also AR, attach 3. These forward pricing rate agreements specifically identify watchman services as an indirect cost for accounting purposes.

² MH explains that it allocates the cost of security guard services at its own facility as an indirect cost because those services are available for both contract-related requirements and its employees' requirements. Because it cannot segregate these costs by function, it charges the cost as an indirect cost.

We conclude that the agency has failed to establish a reasonable basis for increasing MH's evaluated cost to include security guard services for ship's force parking as a direct cost; the record supports the conclusion that the amount of the improper upward adjustment was \$[deleted].³

Fire Watch

MH asserts that the agency improperly increased its evaluated cost to account for certain fire watch services (fire watch services must be provided whenever "hot work" such as welding, or any other fire or spark producing work, is being performed). MH proposed [deleted] hours of fire watch services per availability, but the agency adjusted its proposed hours upward to [deleted] hours per availability. MH concedes that its fire watch services hours were somewhat understated, but asserts that the upward adjustment to [deleted] hours per availability is excessive.

Fire watch hours were calculated as a percentage of production hours under the contract. The parties essentially now agree that [deleted] is the correct coefficient to apply (although during its evaluation, the agency used a figure of [deleted] percent), but disagree regarding the appropriate production hours basis to which the percentage should be applied.⁴ The protester maintains that it should have been applied to a basis of [deleted] production hours, whereas the agency maintains that the appropriate basis is [deleted] production hours (thereby yielding a new figure calculated during the protest of [deleted] fire watch hours per availability). The difference between the parties relates to whether certain hours should have been included in the basis as production hours. The protester maintains that two categories of production hours--"temporary services" and "pumping and cleaning"--should have been excluded because neither of these categories requires performance of "hot work." The agency maintains that it was proper to include these hours because these categories could include hot work.

³ The parties also disagree over the hourly rate applied by the agency in making its upward adjustment, with the agency asserting that it used a rate of \$[deleted] and the protester claiming that a rate of \$[deleted] was used. Based on our review of the record, we are persuaded that the rate applied was \$[deleted]. However, even if the agency were correct, the amount of the improper upward adjustment would be \$[deleted] (37,800 hours x \$[deleted] = \$[deleted] + a combined indirect rate of [deleted] (\$[deleted] x .[deleted]= \$[deleted])= \$[deleted]), which would not change the outcome of our decision here.

⁴ Although the RFP provided for the application of a 9 percent coefficient for purposes of determining the appropriate number of fire watch hours, both parties agree that a higher percentage is more appropriate. The agency now states that it does not find the protester's calculation of a coefficient of [deleted] percent "objectionable." Supp. AR at 7.

We agree with the protester that temporary services and pumping and cleaning should not have been included in the fire watch services calculation. The protester asserts—and the agency has not persuasively refuted—that there is no hot work involved in temporary services. Temporary services are confined to facilities-related work, such as the installation of temporary gangways, landing platforms, piping, lighting, handrails and the like, to enable ready access to the ship for workers and their tools and supplies. MH explains that, because these features involve a connection between the ship and shore, they must be flexible to accommodate the movement of the ship, and that welding, for example, would be impractical because it would result in a rigid, rather than a flexible, connection. MH concludes that all of this work must be accomplished without performing any hot work. Supp. Comments, Sept. 24, 2010, exh. 2, at 2. The protester further explains that cleaning and pumping involves the evacuation and cleaning of shipboard storage tanks that contain flammable materials such as gasoline, oil or lubricants. This work does not involve hot work (after cleaning and pumping the tanks, they must be certified “gas free” before any hot work can occur). *Id.* Again, the agency has not persuasively shown that this work could involve hot work.

Thus, we conclude that it was unreasonable for the agency to include these hours in the production hour basis used in calculating the appropriate number of fire watch services hours that would be required. Accordingly, the appropriate production hours basis is [deleted] hours; applying the [deleted] percent coefficient yields [deleted] hours of fire watch services per availability.

As with the ship’s force parking issue, the protester also asserts that the agency used an inappropriately high hourly rate when calculating the evaluated cost of fire watch services for MH. According to the protester, the agency used MH’s skilled tradesmen average rate of \$[deleted], rather than the rate of \$[deleted] that it proposed. The

agency essentially concedes⁵ that it used an inappropriately high hourly rate. In the final analysis, the record shows that the agency's calculation of the overstatement in this area was unreasonable due to the use of both excessive hours and an unreasonably high hourly rate, and that the overstatement is in the amount of \$[deleted] for labor.⁶ (The agency calculated an understatement in this area of \$[deleted] based on the use of the lower hourly rate, AR at 22, n.19, but this calculation does not take into consideration the reduction of fire watch services hours resulting from the use of the lower production hours basis discussed above.)

Summary

The errors in the agency's cost evaluation discussed above resulted, conservatively, in an overstatement of MH's evaluated cost by \$[deleted].⁷ Reducing MH's evaluated

⁵ The agency suggests that, although it may have used an inappropriately high rate for this component of the work, it used the same average rate in making other upward adjustments in areas such as program management, where the rates used should have been \$[deleted] instead of \$[deleted]; the agency concludes that this offset the effect of the inappropriate high rate used for fire watch services. As discussed above, however, the agency concedes that it made inappropriate additions to MH's program management items based on a miscalculation. When correctly calculated, the agency concedes that it should only have adjusted all three of these management work items upward by a total of [deleted] hours per availability, or [deleted] hours in total over the life of the contract. Supp. AR, Sept. 17, 2010, at 15. Thus, the benefit conferred on MH by virtue of the agency's use of the average hourly rate was an understatement of its proposed cost by only \$[deleted] ($[\text{deleted}] - [\text{deleted}] = [\text{deleted}] \times [\text{deleted}] = [\text{deleted}]$), which is de minimus when compared to the amount by which its evaluated cost for the fire watch services was overstated.

⁶ MH also asserts that the agency overstated its production supervision hours by [deleted] hours. These hours represent the additional supervision hours necessitated by the overstated fire watch services hours. The total amount of the overstatement of MH's evaluated cost because of this error is, according to the protester, \$[deleted]. (We point out that the protester's calculation of this amount reflects the higher, \$[deleted] per hour rate for program management urged by the agency elsewhere and discussed above.) Protester's Supp. Comments, Sept. 24, 2010, exh. 1, attach. 1. The protester appears to be correct as to this item as well, although the amount is not large in relation to the agency's other errors.

⁷ In arriving at this figure, we used the agency's figure of \$[deleted] for the three program management functions and \$[deleted] for the ship's force parking function, based on the lower hourly rate of \$[deleted] the agency asserts is appropriate, and excluded the \$[deleted] for the apparent overstatement of MH's program supervision costs associated with the overstated fire watch services hours.

cost by this amount would move its cost below Earl's. Since the source selection decision was premised on MH's cost being higher than Earl's, we conclude that the source selection decision was unreasonable, and sustain the protest on this basis.

RECOMMENDATION

We recommend that the agency reevaluate proposals in a manner consistent with the discussion above. Following reevaluation the agency should make a new source selection decision. If the agency determines that an offeror other than Earl is in line for award, we recommend that the agency terminate Earl's contract and make award to that offeror.⁸ Finally, we recommend that the agency reimburse MH's costs of filing and pursuing this protest, including reasonable attorneys' fees. 4 C.F.R. § 21.8(d)(1) (2010). MH should submit its certified claim, detailing the time expended and the costs incurred, directly to the agency within 60 days of its receipt of our decision.

The protest is sustained.

Lynn H. Gibson
Acting General Counsel

⁸ During the protest, the agency advised our Office that it was authorizing performance of the contract, notwithstanding the protest, because doing so was in the best interests of the government, and because urgent and compelling circumstances would not permit the agency to await our decision. The record shows that the agency's override decision was limited in terms of the vessels to which it applies and only contemplated work to be performed during the initial year of the contract. AR, exh. 28. To the extent the agency believes that implementation of our recommendation is not practicable, it may request that it be modified.