

# ACC NCR Government Contractors Forum, Venable LLP and PwC: Pricing Government Contracts: What You Need to Know to Win Your Contract and Protect Your Win

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## Why are we here and why is this important today?

- Procurement landscape is increasingly competitive
  - Bid protests are not only common but expected
- Compliance requirements are included as part of award criteria
- Cost estimate must not only be compliant, but compelling
  - Ensure generation of verifiable, supportable, and documented cost estimates
- Pricing issues can result in:
  - Significant TEP adjustment or non-compliant bid
  - Defective Pricing claims
  - Price reductions
  - Litigation



## Common legal/compliance risks during contract pricing and proposal process

|                            |  |   |   |                           |
|----------------------------|--|---|---|---------------------------|
| Commercial item exemptions | Differences between technical, management and cost volumes   | Significant deviations from established practices or business structure | Applicability of contract terms to line items within an IDIQ contract | Cost/Price reasonableness |
| Cost Accounting Standards  | Unsupported bases of estimates                               | Labor category definitions, mapping and rates                           | Status of Business Systems  | Estimating Techniques     |
| Regulatory Thresholds      | Truthful Cost or Pricing Data, Table 15-2, and sweep process | Intercompany transactions   | Cost/Price Realism  | Disclosures               |

**In-house counsel is a “gatekeeper” to identify risks before they become problems**



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## Independent Government Cost Estimate (IGCE)

- The government's own confidential estimated cost/price of the proposed acquisition used to evaluate reasonableness and realism
- Serves as the basis for reserving funds for the contract as part of acquisition planning
- Required for each period of performance (e.g., base award and all option periods)
- Must contain a discussion of how life cycle costs, i.e. "the total cost to the government of acquiring, operating, supporting, and (if applicable) disposing of the items being acquired," will be used in the procurement. FAR 7.101



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## IGCE: Possible Sources of Information

An agency's market research can include information from:

- Historical data
- Commercial pricing catalogs and market surveys
- Requests for Information (RFI)
- Industry Day
- GSA Schedules
- Economic Research Institute databases to set benchmarks
- Comparable data for specific firms/industries from the Defense Contract Audit Agency (DCAA) and the Defense Contract Management Agency (DCMA)

(FAR and "DoD Independent Government Cost Estimate, Handbook for Services Acquisition (Feb. 2018)).



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## Price Reasonableness: Definition

- FAR 15.402(a): Contracting Officers (CO) shall “[p]urchase supplies and services from responsible sources at fair and reasonable prices.”
- The purpose of a price reasonableness review is to determine whether the prices offered are too high, as opposed to too low. *EFW Inc.*, B-412608, et al., Apr. 7, 2016, 2016 CPD ¶ 304.
- FAR 15.404-1(b)(2): “The Government may use various price analysis techniques and procedures to ensure a fair and reasonable price.”



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## Price Reasonableness Basics (FAR 15.402)

The CO shall:

- (1) Obtain certified cost or pricing data when required by 15.403-4, along with data other than certified cost or pricing data as necessary to establish a fair and reasonable price; or
- (2) Obtain data other than certified cost or pricing data when that data is not required by 15.403-4:
  - If price is based on adequate price competition, no other data is needed from the offeror
  - Can include data related to prices, or cost data to the extent necessary



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## Proposal Analysis Techniques (FAR 15.404-1)

Techniques the Government may use include the following:

- Comparison of the proposed prices received in response to a Solicitation
- Comparison to historical prices paid for the same or similar items
  - Must be a valid basis for comparison, prior price must be adjusted to account for changes, and expert technical advice should be obtained
- Use of “rough yardsticks” such as dollars per horsepower, to highlight significant inconsistencies warranting additional pricing inquiry
- Comparison with competitive published price lists, published market prices of commodities, and discount or rebate arrangements
- Comparison with IGCE
- Comparison with prices obtained through market research





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## Price Reasonableness: Examples from GAO

*Metis Solutions, LLC et al.*, B-411173.2 et al., July 20, 2015, 2015 CPD ¶ 221

- Winning offeror's price was approximately 10% higher than the next highest price and 8% higher than the agency's IGCE.
- GAO found the agency's price reasonableness analysis was inadequate because it simply made a generalized representation about the reasonableness of the prices received.

*Crawford Laboratories*, B-277069, Aug. 29, 1997, 97-2 CPD ¶ 63

- GAO found agency's price reasonableness determination defective where prices bid on two "subitems" doubled from the previous contract.
- GAO made this determination despite the fact that the price index for the items was higher (though not double), and the three bids were within a competitive range of each other. The agency did not provide any meaningful support or analysis in the record to support the reasonableness determination.



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## Price Reasonableness: Examples from GAO

*Cognosante, LLC*, B-417111, Feb. 21, 2019, 2019 CPD ¶ 93

- GAO determined agency's reasonableness analysis was flawed where agency stated it would follow FAR 15.404-1(b)(2)(i), but failed to compare offeror final prices, only verified that proposed pricing contained no mathematical errors, and did not determine whether there was a favorable comparison of an awardee's price to its competitor's prices to establish fair and reasonable price

*Technatomy Corporation*, B-414672.5, Oct. 10, 2018, 2018 CPD ¶ 353

- Where agency determined that price reasonableness was implicit where 35 offerors submitted proposals, GAO determined that the presence of competition alone did not render prices *per se* reasonable.
- GAO also determined that the agency failed to identify high pricing, and did not compare offerors' prices.



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## Cost Realism: Definition

- FAR 15.404-1(d): “Cost realism analysis is the process of independently reviewing and evaluating specific elements of each offeror's proposed cost estimate to determine whether the estimated proposed cost elements are realistic for the work to be performed; reflect a clear understanding of the requirements; and are consistent with the unique methods of performance and materials described in the offeror's technical proposal.”
- Required for cost-reimbursement contracts
- May be used in fixed-price contracts



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## Cost Realism Basics

- Cost realism analysis is used to determine the probable cost of each competing offeror for a cost-reimbursement contract. FAR 15.404-1(d)(2).
- Must be performed on cost-reimbursement contracts to determine the probable cost of performance for each offeror
- The government can adjust, when appropriate, the contractor's cost and fee proposed to realistic levels based on the results of the cost realism analysis
- Focuses on the reasonableness of the estimated costs of performance, not the reasonableness of the contract price



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## Proposal Analysis Techniques (FAR 15.404-1)

Cost analysis techniques the Government may use include the following:

- Verification of cost or pricing data and evaluation of cost elements, including:
  - Necessity for proposed costs, including allowances for contingencies
  - Projection of offeror's cost trends on the basis of current and historical data
  - Reasonableness of cost estimates generated by models
  - Application of audited or negotiated indirect cost rates, labor rates, etc.
- Evaluating the effect of the offeror's current practices on future costs
- Comparison of costs proposed by the offeror for individual cost elements with:
  - Actual costs previously incurred by the same offeror
  - Previous cost estimates from the offeror or from other offerors for same or similar items
  - Other cost estimates received
  - IGCEs by technical personnel
  - Forecasts or planned expenditures



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## Proposal Analysis Techniques Continued

Techniques may also include:

- Verification that an offeror's cost submissions are in accordance with contract cost principles and procedures in FAR Part 31 and the Cost Accounting Standards
- Reviewing proposals to determine whether any cost or pricing data necessary to make the contractor's proposal accurate, complete, and current have not been either submitted or identified in writing by the contractor
- Analysis of the results of any make-or-buy program reviews, in evaluating subcontract costs



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## Cost Realism: Examples from GAO

*Sotera Defense Solutions, Inc.*, B-414056 et al., Jan. 31, 2017, 2017 CPD ¶ 46

- Determining that agency's cost realism evaluation was reasonable where agency examined the offeror's proposed level of effort and labor categories, used three separate and distinct data points to evaluate cost realism, compared labor rates to the national average for each labor category, and created a statistical model for comparison using labor rates proposed by all offerors and proposed subcontractors.

*BlueWater Federal Solutions, Inc.*, B-413758, Dec. 12, 2016, 2016 WL 7367630

- Offeror's proposed cost was unrealistic where costs were not consistent with the technical solution described in technical proposal.



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## Cost Realism: Examples from GAO

*Glacier Tech. Solutions, LLC*, B-412990.2, Oct. 17, 2016, 2016 CPD ¶ 311

- GAO determined that the agency's upward adjustment to Glacier's labor categories was reasonable where the agency compared Glacier's rates to Bureau of Labor Statistics rates, and found that Glacier's justification for its low rates did not sufficiently explain how those employees could possess the skills and be able to adequately perform the necessary requirements.

*Smartronix, Inc.*, B-411970 et al., Nov. 25, 2015, 2015 CPD ¶ 373

- Determining that agency's cost realism analysis was unreasonable where the agency only compared proposed rates to market data and failed to conduct any realism analysis for individual labor categories, failed to consider inconsistency in proposed rates and offeror's submitted supporting cost data, and failed to consider realism of offeror's proposed unburdened labor hour rates.





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## Unit Prices (FAR 15.404-1(f))

- Offerors may not use any method of distributing costs to line items that distorts the unit prices under the contract
  - Unit prices must reflect the intrinsic value of an item or service
  - Must be in proportion to an item's base cost (e.g., manufacturing or acquisition costs)
- An exception is made when an item is priced on the basis of adequate price competition, or catalog, or market price
- COs will require that offerors identify in proposals items that the offeror will not manufacture or to which the offeror will not contribute significant value, unless adequate price competition is expected



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## Unbalanced Pricing (FAR 15.404-1(g))

- Exists when, despite an acceptable total evaluated price, the price of one or more line items is significantly over or understated as indicated by the application of cost or price analysis techniques
- The risks occur when:
  - Startup work, mobilization, first articles, or first article testing are separate line items
  - Base quantities and option quantities are separate line items
  - Evaluated price is aggregate of estimated quantities to be ordered under separate line items of an indefinite-delivery contract
- COs will analyze all offers with separately priced line items for unbalanced pricing – may reject offers if an unacceptable risk is found



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## Contractor Business Systems

### DFARS 252.242-7005

Applicable to Department of Defense (DoD) contracts that are subject to the Cost Accounting Standards (CAS) – modified or full coverage

Definitions:

- **Acceptable contractor business system** - contractor business systems that comply with the terms and conditions of the applicable business system clauses
- **Significant Deficiency** - a shortcoming in the system that materially affects the ability of officials of the Department of Defense to rely upon information produced by the system that is needed for management purposes

Withhold of 5% for each disapproved system with a 10% maximum withhold for multiple disapproved systems

- Systems:
  - Accounting, 252.242-7006
  - Estimating, 252.215-7002
  - Purchasing, 252.244-7001
  - MMAS, 252.242-7004
  - Property Management, 252.245-7003
  - EVMS, 252.234-7002



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## DFARS Contractor Business Systems Rule

### Observations on the Current Environment

Approved business systems may be a condition for contract award

- SysVets, LLC, B-415694 (February 13, 2018)
  - Service-disabled veteran-owned business (SDVOSB) joint venture
  - Challenged the elimination of its proposal for IT services and service-based solutions from consideration for award pursuant to GSA SDVOSB set-aside
  - SysVets only provided documentation that its majority member's accounting system was approved; no documentation was provided for the other two joint venture members' accounting systems
  - SysVets filed protest arguing that GSA's deduction of 5,000 points under the cost accounting system element was unreasonable
  - Protest denied; failed to comply with solicitation requirement to provide documentation of adequate accounting system for each joint venture member (i.e., either at the joint venture level or for each joint venture member)



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## DFARS Contractor Business Systems Rule

### Observations on the Current Environment

Approved business systems may be a condition for contract award (continued)

- Leader Communications, Inc., B-413104.9 (March 17, 2017)
  - Leader protested the Department of Health and Human Services' exclusion of its proposal based on a failure to submit verification of an adequate cost accounting system from DCAA
  - Leader's proposal stated that its accounting system was approved by DCAA in 2008 and referenced the audit number, but Leader did not submit verification
  - GAO denied Leader's protest on the grounds that Leader did not provide verification from DCAA that its accounting system had been audited and deemed adequate



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## DFARS Contractor Business Systems Rule

### Observations on the Current Environment

Approved business systems may be a condition for contract award (continued)

- Evolver, Inc.; Armed Forces Serv. Corp., B-413559.2, B-4133559.8 (December 21, 2016)
  - GSA issued a solicitation giving preference to firms with a federally audited and approved accounting system
  - RFP provided for “points” for approved accounting and purchasing systems
  - To earn points, offerors had to provide supporting documents from DCAA, DCMA or Cognizant Federal Agency that system had been audited
  - GAO determined this evaluation preference is acceptable for the cost-reimbursable, DoD task orders



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## DFARS Contractor Business Systems Rule

### Observations on the Current Environment

Approved business systems may be a condition for contract award (continued)

- *AttainX, Inc., FreeAlliance.com, LLC*, B-413104.5, B-413104.6 (November 10, 2016)
  - Solicitation required bidders to submit verification of an adequate accounting system from a third party CPA firm or DCAA/DCMA
  - AttainX and FreeAlliance.com failed to comply with solicitation's specific requirement that verification of an adequate accounting system from a third party CPA firm must be provided on the CPA firm's letterhead
  - Requirement for verification is not expressly stated in FAR, but was a specific solicitation requirement
  - GAO denied the protests and concluded that protesters were not eligible for contract award



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## Intercompany Transactions

- What is an intercompany transaction?
  - A transaction with any divisions, subdivisions, subsidiaries, or affiliates of the contractor under a common control
  - May include any of the following transactions with an affiliated entity:
    - Subcontracts, teaming arrangements, loaned labor, joint IR&D/B&P efforts, lease arrangements, transfer of assets, shared services and cost allocations
- FAR Part 31.205-26(e) requires transfers between affiliates to be on the basis of **cost**. Transfers may be at **price** in the following circumstances:
  - The transferring organization has an established practice to price transfers at other than cost for commercial work, and
  - The item being transferred qualifies for an exemption under FAR 15.403-1(b) (certified cost or pricing data), and
  - The contracting office has not determined the price to be unreasonable
- Intercompany transactions generally face increased government scrutiny
- Contractors are required to disclose these transactions and document any exceptions that allow transfers at price





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## A-T Solutions, Inc. – Intercompany and specific disclosure of commercial items exemption

ASBCA No. 59338 (February 8, 2017)

- Intercompany & specific disclosure of commercial items exemption
- A-T Solutions, Inc. (ATS) successfully appealed a Contracting Officer's final decision
- ATS proposed that certain training materials were commercial items
- After award, the government claimed that ATS only satisfied 2 of the 3 requirements (FAR 31.205-26(e))
  - Materials were commercial items and the price was not unreasonable
  - ATS did not demonstrate an established practice of pricing interorganizational transfers at other than cost
- ASBCA Decision
  - Government failed to carry its burden of proof to justify the disallowance of costs under FAR 31.205-26(e)
  - ATS demonstrated an “established practice” by using catalog prices and separate sales accounts
  - FAR 31.205-26(e) does not impose an “economic substance” requirement



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## DFARS Proposal checklist

- The DFARS proposal adequacy checklist is a helpful tool for in-house counsel to use in reviewing contract proposals (even for proposals for non-DoD solicitations)
- Covers general proposal requirements and requirements for specific cost elements
- Checklist can be found at DFARS 252.215-7009
- In addition to items discussed earlier, the checklist includes the following considerations:
  - Time-phased breakdown of labor costs for appropriate indirect cost allocation
  - Identify subcontractor proposals for which the contracting officer may need to request field pricing analysis
  - identify any direct contract costs incurred for work performed prior to proposal submission
  - Identify the nature and amount of any contingencies



# Thank you!

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