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PATENT AND TRADEMARK OFFICE

*PTO Needs to Refine Its Space
Consolidation Planning*

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TABLE OF CONTENTS

EXECUTIVE SUMMARY	i
PURPOSE AND SCOPE	1
BACKGROUND	2
OBSERVATIONS AND CONCLUSIONS	8
I. PTO Should Continue with the Space Consolidation Effort	8
A. Justification for the Procurement Is Valid	8
B. PTO Is Managing Many Aspects of the Space Consolidation Project Well	9
II. PTO Needs to Finalize Its Space Planning	11
A. PTO Has Not Finalized Its Space Allocation Plan	11
1. PTO believes it can turn back unneeded space to GSA	12
2. Not all PTO union agreements are in place	13
B. PTO Has Not Properly Considered Certain Variables in Its Space Planning	14
1. PTO's requirements ignore reengineering and automation initiatives that could reduce its space needs	14
2. Trademark work-at-home pilot project could reduce PTO's space requirements	18
3. PTO paid rent on vacant space	19
III. PTO Build-Out Plan Requires Risk Management	22
A. PTO's Build-Out Approach Is a Result of Risk Analysis	22
1. Specifying the build-out with detailed drawings	22
2. Specifying detailed price lists for all build-out items	23
3. Providing for a build-out allowance for unspecified work effort	23
B. PTO's Build-Out Allowance Method Contains Considerable Risk	25
1. Cost risk	25
2. Schedule risk	30
IV. PTO Has No Interagency Agreement with GSA for the Lease Project	34
A. GSA's Fee Structure Is Undefined	34
1. GSA's fee for the build-out effort	34
2. GSA's scaled fee for the term of lease	35
B. MOU Needs to Address PTO's Right to Turn Back Unneeded Space to GSA	36
C. PTO Should Continue Using GSA for the Construction and Management of the Lease Development	37

V.	The Department Needs to Improve Its Real Estate Management Oversight	39
	RECOMMENDATIONS	41
	APPENDICES	43
I.	Space Prospectus Approval Timeline	43
II.	Space Acquisition Project Milestones	44
ATTACHMENT 1	Patent and Trademark Office’s Response to the Draft Report	
ATTACHMENT 2	Department of Commerce’s Response to the Draft Report	
ATTACHMENT 3	General Services Administration’s Response to the Draft Report	

EXECUTIVE SUMMARY

In October 1995, the Patent and Trademark Office was granted congressional authorization to procure up to a 2.4 million rentable square foot¹ facility in Northern Virginia to consolidate its facilities and operations and accommodate space expansion needs. Currently, PTO has approximately 1.7 million square feet of occupiable space in 16 leased buildings in Crystal City, Virginia. The bureau's space needs are expanding, however, owing to a continuing growth in patent and trademark applications.

On behalf of PTO, the General Services Administration (GSA) plans to award a contract to a private developer to construct and lease back a new or renovated facility to PTO for at least a 20-year period. The approved prospectus requires a facility that yields just under 2.0 million occupiable square feet. In accordance with the congressional authorization, the maximum annual rent is not to exceed \$57.3 million, which equates to \$24 per rentable square foot. To compensate the developer for inflation, the lease rate is escalated at an annual rate of 2.9 percent from the approval of the prospectus until occupancy of the facility.

In June 1996, GSA issued a Solicitation for Offers (SFO) calling for a 20-year firm lease term, including defined purchase options. The lease development contract award is anticipated for October 1998, with occupancy of the first block of space of approximately 1.3 million square feet to begin in November 2001. Four finalists for the project were selected in March 1997, and their proposals were received on October 27, 1997. The SFO has broken the award into two phases. In Phase I, the offerors were evaluated on their development team and experience, their financial capability, the proposed site of the leased facility, and an environmental assessment of the site. In the October 27 Phase II proposals, the offerors were to present an update of their Phase I offers, site development information, the building design, the qualifications of the interior architect, the qualifications of the operations and maintenance team, the development schedule, and the priced offer for the entire development project.

The SFO calls for the construction of a base building, to include basic electrical and mechanical systems (the "cold, dark shell"), which will be "built-out" upon completion of the interior design. The SFO allows the lease development to be awarded based on the developer's design of the cold, dark shell, with the government supplying the build-out interior space allocation plan. The successful developer will then also design the interior upon award of the lease development contract. The build-out of the shell is to be accomplished with an allowance of \$88 million

¹ The Congress authorized 2.4 million rentable square feet, which GSA translated to 1.989 million square feet of occupiable space. See page 2 for the difference between "rentable" and "occupiable."

expressly financed through the lease payments and at least an additional \$29 million financed directly by PTO.

Our inspection revealed that PTO is managing many aspects of the lease development procurement well. The PTO/GSA procurement strategy and its execution have generally been successful. PTO has supported the basic requirements for and benefits of the new lease development based upon its need for modern, contiguous space that (1) is compliant with the Americans with Disabilities Act and municipal health and safety codes and (2) will ultimately result in facilities that are more efficient and less expensive than its current facilities. Specifically:

- ! Long-term cost savings should be realized because the current leased PTO space is more expensive than the \$24-per-square-foot target authorized by the Congress and specified in the SFO.
- ! Significant growth in the number of patent and trademark applications has increased PTO's workload, and the new facility should allow PTO to better meet its future staffing and space requirements.
- ! Most of PTO's current leased facilities in Crystal City are in need of alterations to comply with fire, safety, and handicapped accessibility laws.
- ! Access for PTO and its customers, both to the facility itself and within the public search areas, should be improved (see page 8).

While PTO should benefit from this lease development project, maintaining competition in the PTO space acquisition is critical if the government is to receive the greatest possible benefit from the project.

Space Planning

Notwithstanding the reasonable strategy and progress on the overall procurement to date, we are concerned about some aspects of PTO's planning and management of this enormous and important procurement. In general, our concerns center on the need for PTO to better define its space requirements. For example:

- ! **PTO needs to finalize its space requirements.** Although only seven months remain before the lease award, PTO has not finalized its space requirements. On February 6, 1998, and in response to our draft report, PTO presented its draft Space Allocation Plan dated October 1, 1997. Although this plan describes the bureau's space requirements in

detail and supports its need for 1,989,116 occupiable square feet, it cannot be incorporated into the lease development contract until it is finalized (see page 11).

- ! **PTO has not reached an agreement with its bargaining unit employees over working conditions related to space requirements.** Absent a firm agreement with its union employees regarding the amount of space each employee will receive in the new facility, PTO cannot prepare its detailed space plans and program of requirements (POR) for the build-out of the new facility. At this juncture, given the lack of union agreements, we are concerned the build-out requirements and POR will not be defined by the scheduled contract award in October 1998. This could cause a major delay in the award schedule and an increase in project costs (see page 13).
- ! **PTO has not factored in the potential savings and efficiencies possible through systems reengineering and automation.** For years, PTO has invested heavily in systems reengineering and automation initiatives. Many of these initiatives are designed to achieve greater efficiencies and increased productivity by reducing PTO's staff and space needs and reducing its paper files and the space they require. PTO has only factored some of these initiatives, specifically the reduction in paper patent search files, into its planning for the new facility. PTO makes the presumption that reengineering and automation initiatives will not have a beneficial impact until after occupancy of the new facility. We believe that even partial success on only a few of the reengineering initiatives will result in some benefit and should reduce PTO's space requirements (see page 14).
- ! **PTO paid rent on vacant space.** For approximately eight months, from March to October 1997, PTO had a large inventory of vacant space that was rented and inappropriately set aside for a reorganization of several patent groups by industry sectors, in advance of congressional authorization. As a result, PTO carried more than 73,000 occupiable square feet of vacant space. The total cost of this error was almost \$1.5 million because PTO paid an average of \$30 per square foot to rent this vacant space. However, this space is currently in use (see page 19).

Build-Out Risk

We are concerned with the methods PTO is employing to pursue the build-out of the cold, dark shell. PTO's build-out process needlessly exposes the government to increased cost risk. Specifically, the project may increase in cost before completion, and be delayed, also resulting in increased costs (see page 22).

- ! **PTO's build-out strategy exposes the bureau to cost overruns.** PTO's build-out strategy calls for a pool of \$88 million to be set aside for undefined completion, or build-

out, of the shell of the building. The \$88 million build-out allowance will be funded through the lease with the developer. In addition, however, PTO is planning to spend at least \$29 million in additional funds for upgraded building systems and interiors. This process is flawed because the lease development project lacks a defined cost ceiling. Our specific concerns include the following:

- PTO does not have a final budget for the build-out, and there is no ceiling amount specified in the SFO to limit the government’s financial exposure (see page 25).
- The absence of a defined ceiling for the build-out may act as an incentive for the developers to “buy-in” on their initial offers with the hope of “getting well” on the inevitable changes to the less precisely defined work (see page 26).
- Because of the lack of build-out specifications, the offerors are subject to performance risk, which may be incorporated into their offers as cost contingencies, increasing the cost to the government (see page 29).
- The lack of the build-out specifications increases the likelihood of change orders to correct incomplete specifications or correct deficient ones (see page 29).

! **PTO’s build-out strategy exposes the bureau to program delays.** The SFO requires the government to issue the build-out specifications, or POR, upon lease award in October 1998. However, PTO has not finalized its space requirements, and cannot develop its POR. The lack of this POR describing the build-out exposes the government to schedule risk and the likelihood of delay costs and numerous change orders because of incomplete specifications. Specifically:

- Delays in lease award may result in lease escalation, payment of rent in advance of occupancy, or having to pay the cost of the developer’s idle work force. In the extreme, a lengthy delay in lease award may result in one or more developers losing their financing, potentially resulting in the scuttling of the entire project, with the government liable for the withdrawing offerors’ proposal preparation costs (see page 30).
- Delays in the build-out of the cold, dark shell are to be mitigated by a well-conceived array of remedial measures. These measures are contingent, however, upon PTO developing the POR upon lease award, as the POR is a condition precedent to the entire build-out methodology in the SFO (see page 31).

Lack of an Interagency Agreement with GSA

We are also concerned that PTO does not have a written interagency agreement with the General Services Administration, defining the rights and obligations of each agency and allocating the underlying project risk between them. Absent such an agreement, we have identified several key concerns:

- ! **The fee structure for GSA's effort is undefined.** Absent a written interagency agreement, the fee structure between the agencies is not defined. Discussions between the agencies regarding GSA's fee for managing the build-out have included the possibility of a cost-based fee of between three and nine percent of incurred costs. Although recent discussions between PTO and GSA focus on fixed fees as a portion of rental payment, we have two concerns relevant to a cost-based fee arrangement in the contractual context:
 - The build-out is not defined by a budgetary ceiling, and GSA is expected to receive a percentage of the costs incurred. This equates to a cost-plus-percentage-of-cost fee arrangement, which is prohibited by statute (see page 35).
 - In the event GSA receives any fee above six percent, it would be receiving a fee in excess of the statutory ceiling for a cost-type construction or architect-engineering contract (see page 35).

- ! **PTO's right to turn back unneeded space has not been defined.** The two agencies have not determined whether, or under what terms, PTO may turn back unneeded space to GSA. As the traditional lease holder for the federal government, GSA had, in years past, a generous policy of accepting unneeded space from its agency customers. This policy, however, may be strained by the sheer magnitude of this lease development, the expiration of the Federal Property Management Regulations, and evolving GSA policy regarding accepting relinquished leased property. Additionally, it is not clear how PTO's possible change to a performance-based-organization (PBO) would affect its ability or desire to turn back space to GSA (see page 36).

- ! **GSA's continuing role as construction manager has not been defined.** The Public Buildings Act specifies that only GSA may construct or manage the construction of buildings designated for federal government use. In the event that PTO attains PBO status, PTO might be exempt from the federal property statutes and could pursue the build-out phase of its lease development project independent of GSA. As the federal government expert in construction and construction management, GSA should have a continuing role in the completion of the new PTO facility (see page 37).

Lack of Departmental Oversight

Finally, we are concerned that the Department has not been adequately involved in the PTO lease development process, one of the largest federal construction or lease projects in the Washington, D.C., Metropolitan Area.

- !** **The Department needs to improve its real estate management oversight.** The Department's real property staff has not adequately monitored the progress of this important lease development project. In particular, the Department has failed to foresee PTO's late start and the slow progress of its union discussions, which are critical in determining PTO space requirements, and may delay award of the contract (see page 39).

On page 41, we offer a number of recommendations to address our concerns.



In response to our draft report, PTO agreed to most of our recommendations, but there were some areas of strong disagreement.

With regard to our recommendation that this lease development project continue, PTO as well as the Department and GSA, agreed. PTO again emphasized its need to acquire more efficient space and to lower its rent costs. The Department stated that with all of PTO's current leases expiring in the 2000 - 2002 time frame, this is a unique opportunity to consolidate PTO's operations, while avoiding future non-competitive lease rates.

Our draft report expressed our concern that PTO had failed to fully determine its space requirements. Although PTO and GSA did prepare space planning documents, these were several years old and did not allocate space by projected employee headcount. The SFO contains a provision allowing PTO to forgo construction of up to 300,000 square feet of occupiable space in blocks of 100,000 square feet. At the time of our field work, we were concerned that PTO was not performing an adequate space analysis and was thereby missing its opportunity to build less space if, in fact, less space was required. We were also concerned that PTO played down the risk of obtaining too much space because it believed that GSA would be willing to take back unneeded space.

In the absence of a current, detailed space plan from PTO, we prepared a calculation of PTO's space requirements using the now-expired Federal Property Management Regulations (FPMR). Based on these estimates, we determined that PTO would not need all of the office space in its prospectus for its projected 7,108 employees in 2001. Using the FPMR guidelines, we calculated that PTO could forgo the construction of 87,000 occupiable square feet of space. Rounding

these calculations, we concluded that PTO should consider forgoing the construction of one block of 100,000 square feet of office space.

In response to our draft report, PTO submitted a draft Space Allocation Plan, dated October 1, 1997, which had not been previously made available to us. Had we been aware of the existence and details of this plan (which appears to have been created by PTO prior to the issuance of our draft report) we would have modified our draft report recommendation that PTO consider forgoing the construction of at least 100,000 occupiable square feet of office space. This plan calculates the bureau's space requirements using a bottom's up approach from the detailed space elements, by individual, special or joint purpose, up to a total requirement. We have reviewed the detailed projections for office space, allocated by headcount, and have now concluded that PTO has documented its requirements for the 1,989,116 occupiable square feet authorized by the Congress.

PTO has also advised that its largest labor union, the Patent Organization Professional Association, has filed a claim against PTO at the Federal Labor Relations Authority, alleging that the issuance of the SFO without first negotiating space-related working conditions with the union constituted an unfair labor practice. The lack of resolution of this matter could delay the development of the POR, which in turn could delay the lease development project.

With regard to our recommendation that PTO consider its reengineering initiatives in the space requirements, PTO has incorporated space savings in its draft Space Allocation Plan through the elimination of the paper patent examination search files. Further, PTO and the Department have responded that the other systems reengineering efforts will not yield space savings until after the new facility is occupied.

In response to our recommendation that PTO develop an estimate for the build-out of the facility and establish this as a contractual ceiling, PTO agreed that there should be an absolute limit on the government's liability for the build-out, but disagreed that the SFO as drafted does not set such a limit. Furthermore, PTO said it would be inappropriate to include any reference to the \$29 million for above FPMR build-out items in the SFO because the government cannot guarantee that such funds will be made available or expended. Nor did PTO think it was appropriate to create a contractual obligation to commit these funds for build-out of the facility. PTO does not agree that failure to establish a contractual ceiling would increase the project risk to the government.

PTO has acknowledged that it has no need for its own Contracting Officer's Representative (COR) until after the facility has been constructed and lease payments commence. Further, PTO will propose language in its MOU with GSA to clarify this understanding. When PTO and GSA do execute a written MOU, PTO will include a clause restricting the bureau from appointing its COR until after the completion of construction. We agree with this course of action.

In response to our recommendation that PTO execute a written MOU with GSA, all parties-- PTO, GSA and the Department--have agreed this should be done. As of this writing, however, the MOU has not been executed. We encourage PTO and GSA to resolve any remaining issues of pricing and service delivery. We understand that an MOU between PTO and GSA is in the late stages of development.

In response to our recommendation that the Department provide oversight, assistance, and guidance to the PTO space project, the Department has maintained a higher level of involvement in the project, especially in recent months. The Department has assigned both real property and procurement personnel to coordinate ongoing planning activities and assist in the source selection process.

In response to our recommendation that the Department establish effective oversight policies and procedures for future lease development projects, the Department recently created Chapter 10 of the Real Property Management Manual. This new chapter describes the Department's policy regarding any prospectus-level repair, alteration, construction, or lease project.

PURPOSE AND SCOPE

The purpose of this inspection was to review PTO's planned acquisition of a consolidated 2.4 million rentable square foot² facility in Northern Virginia in order to determine whether (1) the facility is justified in terms of cost and other non-cost factors, (2) the expansion of PTO space is justified by projected workload and staffing projections, (3) PTO is effectively managing the project, (4) PTO has properly taken into account variables that will affect the size, scope, and cost of the facility in its plans, and (5) PTO has adequately identified future risks that may alter the cost of this facility and affect outlays, both during construction and throughout the lease period.

Our review focused on evaluating the structure and approach that PTO has taken in this procurement, which will cost PTO at least \$1.1 billion over the 20-year lease term. We reviewed PTO's program files and all major contract deliverables related to the project. We also analyzed relevant documents, legislation, and prior lease consolidation studies, and interviewed officials throughout PTO, the Department, and the General Services Administration (GSA). Our review was conducted in accordance with the Inspector General Act of 1978, as amended, and the *Quality Standards for Inspections* issued by the President's Council on Integrity and Efficiency.

² The prospectus approved by the Congress calls for up to 2.4 million rentable square feet. GSA has translated this requirement to 1,989,116, or about 2.0 million square feet of occupiable space.

BACKGROUND

PTO's Mission

The Patent and Trademark Office administers the laws relating to patents and trademarks, promotes industrial and technical progress, and thereby strengthens the national economy. Patent law encourages technological advancement by providing incentives to inventors to disclose their technology and to investors to invest in that technology. PTO's primary role in administering these laws is to examine patent applications and grant protection to qualified inventions. In addition, PTO is responsible for collecting, assembling, publishing, and distributing technical information disclosed in patent grants. Trademark law assists businesses in protecting the reputation of their goods and services, and safeguards consumers against confusion and deception in the marketplace. PTO examines trademark applications and grants federal registration to owners of qualified marks. In 1996, PTO issued 116,875 patents out of 206,276 applications, and registered 91,339 trademarks out of 200,640 applications.

Justification for Space Acquisition

Since 1989, PTO, with the assistance of GSA, has been seeking to consolidate its offices. PTO currently occupies all or parts of 16 building sites in the Crystal City area of Arlington, Virginia, under 32 separate leases. In addition, PTO leases two warehouse storage facilities in Newington, Virginia. Some buildings are leased floor by floor, with each floor requiring a separate lease. The total square footage of PTO's current space is approximately 1.7 million occupiable square feet, of which about 1.4 million is office space.³ Much of the difference represents areas for which the government pays rent, but which are not useful as office space, such as elevator lobbies, stairways, elevators and elevator shafts, rest rooms and lounges, ventilation stacks, and shafts and corridors required by local codes and ordinances for minimum safety.⁴ Currently, PTO has about 6,460 employees, including contractor personnel housed at the various PTO facilities. PTO projects that by fiscal year 2001, it will grow to over 7,600 employees and require about 2.0 million occupiable square feet of space.

The primary justification for PTO's new facility development continues to be a 1991 study prepared by a contractor for GSA, called the Daly Study.⁵ The Daly Study concluded that PTO's

³ The 1.4 million square foot figure includes "other" and "miscellaneous" space of 89,617 rentable square feet and "vacant" space of 73,000 rentable square feet.

⁴ Solicitation for Offers, GSA solicitation no. 96.004 at Section A, page 12. Hereinafter referred to as SFO.

⁵ *Prospectus Development Study: Patent and Trademark Office*, Leo A. Daly, 1991.

facilities at the time prevented the agency from operating at maximum efficiency, and would not allow for logical expansion to accommodate the larger staff needed to handle an expected workload increase. The study concluded that PTO needs would best be met in a cost-effective manner by consolidating its disparate pieces into a single complex. The study projected that PTO would grow to more than 8,000 employees by fiscal year 1996 and would require about 2.0 million occupiable square feet that it would begin occupying by that year. These estimates formed the basis of the prospectus submitted to the Congress.

PTO has stated that its primary reasons for consolidating and expanding its space are: (1) its current leased facilities in Crystal City are in need of alterations to meet fire, safety, and handicapped accessibility guidelines; (2) the various PTO technology groups need to be located in physical proximity to one another for efficient operations, as compared to the current dispersion of groups and facilities among PTO's 18 facilities; (3) more space is needed to house significant staff increases due to the continued growth in patent and trademark applications; and (4) long-term cost savings can be realized with consolidation and more efficient facilities. PTO's current leased office space, procured through 32 separate, sole-source and piecemeal leases, costs an average of \$25.78 per square foot,⁶ which is higher than the maximum annual rent of \$24 per square foot authorized by the Congress for PTO's new facility.⁷ This remains true even after the \$24 per square foot rate is escalated by 2.9 percent per year, for two years, as provided for in the Solicitation for Offers (SFO), and includes the \$88 million build-out allowance. Not included are the PTO-funded above standard build-out additions.⁸ Therefore, PTO stands to gain a newer facility that complies with fire and safety codes and the Americans with Disabilities Act (ADA) at a lower rate per square foot than it is currently paying.

In a 1992 audit of PTO's space acquisition project, we found that PTO's projections for increased space and staff to support this procurement were overstated.⁹ We also noted other issues that could affect PTO's future space requirements—such as a proposed “work-at-home” program for

⁶ This figure represents the cost that GSA pays to the current landlords for rentable square feet of space. PTO pays GSA approximately \$30 per square foot, after adding agency fees and other costs.

⁷ The maximum annual rent per square foot is derived from the congressional authorization, which specifies the estimated maximum annual cost of \$57 million and a range of 2.2 million to 2.4 million rentable square feet. The \$24 per square foot rate is calculated by dividing the \$57 million by the 2.4 million rentable square feet, the higher amount of the range, rounded up. GSA determined that the \$24 per square foot rate was appropriate for this lease development.

⁸ By comparison, office space at the Ronald Reagan Federal Building and International Trade Center in the District of Columbia is being leased at a rate of \$35 per square foot through fiscal year 1999 (including GSA's fees), after which market rates will be applied.

⁹ *Future Resource Requirements for PTO Are Overstated*, EAD-4421-2-0001, September 30, 1992.

some employees and the deployment of the Automated Patent System (APS). As a result of our 1992 report, PTO added a provision to the solicitation that would allow the government to forgo the construction of up to 300,000 square feet in increments of 100,000 square feet.

History of Prospectus

PTO's space acquisition process is years behind the original schedule. The primary reason for this was PTO and GSA's inability to obtain approval of a prospectus from the Office of Management and Budget (OMB). It took several years of negotiations and many draft prospectuses to secure OMB approval. GSA and PTO first submitted a draft prospectus to OMB in the fall of 1991, but one was not approved until May 1995. Appendix I contains a time line of the many space prospectuses.

The primary problem at OMB related to the scoring rules as contained in the Omnibus Budget Reconciliation Act of 1990, which set specific limits on the size of the federal deficit for fiscal years 1991 through 1995. The rules require that for any purchase, lease-purchase, or capital lease, the entire cost of the obligation is to be recorded in the first fiscal year for which the budget authority is made available. However, operating leases are not scored if they meet the criteria set forth in OMB Circular A-11.

The 20-year lease for PTO, with a maximum annual rental cost of \$57 million, would cost a total of \$1.1 billion. Since it contained a purchase option, OMB initially had concerns that this would require scoring the lease up-front. However, after GSA explained its intent to include language in the SFO stating that the government would not pay a rent premium for any purchases option, and to seek both prospectus and budget authority for any actual purchase, OMB concurred that the project should be scored as a capital lease.

Congressional Approval and Issuance of the SFO

The prospectus was approved by the Senate Committee on Environment and Public Works in October 1995,¹⁰ and by the House Committee on Transportation and Infrastructure the following month.¹¹ The SFO was issued by GSA on June 26, 1996. In accordance with the approved prospectus, the SFO calls for a facility of approximately 2.2 to 2.4 million rentable square feet, to

¹⁰ S. COMM. ON ENVIRONMENT AND PUBLIC WORKS, COMM. RES. 104TH CONG. 1ST SESS. (October 24, 1995).

¹¹ H.R. COMM. ON TRANSPORTATION AND INFRASTRUCTURE, COMM. RES. 104TH CONG. 1ST SESS. (November 16, 1995).

be located within a delineated area of Northern Virginia. The SFO further requires that either the site be located within walking distance from a Metrorail station or the lessor provide free, dedicated shuttle bus service to the nearest Metrorail station for PTO employees and customers. The facility must consist of no more than eight adjacent and interconnected buildings.

The SFO also describes occupiable space as “that portion of rentable space that is available for PTO’s personnel, equipment, and furnishings.” It does not include space set aside for rest rooms and lounges, stairwells, elevators and escalator shafts, building equipment and service areas, entrance and elevator lobbies, and corridors required by local codes and ordinances. Rent will be paid on the total “gross area” of occupiable and general use space. As specified by the SFO, the rentable space shall not exceed 2.4 million square feet.

PTO’s Procurement Approach

PTO has pursued a multi-step procurement to obtain its leased facility. The SFO breaks the award process into two steps, or phases.¹² In Phase I, the offerors were evaluated on their development team and experience, the proposed site of the leased facility, a presentation on their financial capability, and an environmental assessment of the proposed site. Five Phase I proposals were received on December 23, 1996. Upon evaluation, one of these offerors was excluded from the second phase. There was no bid protest at this juncture.

In Phase II, which began on October 27, 1997, the offerors presented an update of their Phase I offers, site development information, a building design, the qualifications of the interior architect, the qualifications of the operations and maintenance team, a development schedule, and the priced offer itself. The lease award is to be made from the four finalists after analysis of their Phase II offers. A best and final offer (BAFO) process is expected, and the development lease award is scheduled to be awarded in October 1998.¹³

¹² The two-step source selection process was enacted as part of the Defense Authorization Act (Pub.L. 104-106). This law amends Section 303(m) of the Federal Property and Administration Services Act of 1949. The two-phase source process may be used when three or more offers are expected, and where design work is required before a cost or price proposal can be developed. In Phase I, the agency selects the number of offerors specified in the solicitation, or SFO (usually up to five), based on their technical approach, past performance, and specialized and technical qualifications. Cost or price factors are not used in the initial “shortlisting” of offerors. In Phase II, the selected contractors develop more detailed proposals, which include cost or price to complete the projects and address other factors outlined in the solicitation.

¹³ The award date was changed from July 1998 to October 1998, by amendment to the SFO. The award date was changed at the offerors’ request and to allow more time for environmental planning.

The SFO calls for the construction of a “cold, dark shell,” which will be “built-out” upon completion of the interior design. The SFO allows the lease development contract to be awarded based on the developer’s design of the shell with the government supplying the build-out of the interior design at the time of lease development award.¹⁴ The build-out of the shell is to be accomplished with an allowance of \$88 million dedicated to that purpose, and is expressly financed through the lease payments. PTO is adding at least an additional \$29 million to the build-out for above-GSA standard accouterments. PTO is just now attempting to finalize its space use planning to determine the space requirements for its various groups and functions necessary to accomplish its mission. With the issuance of this final report, PTO has only seven months to complete its space planning for the entire 2 million square foot facility (see page 11).

The SFO calls for a 20-year firm lease term, with defined purchase options. The maximum annual rent per the congressional authorization equates to \$24 per rentable square foot. Occupancy of the first block of space of approximately 1.3 million square feet is scheduled to begin in November 2001. The SFO’s terms allow PTO to forgo the construction and lease of up to 300,000 square feet of building space in increments of 100,000 square feet. If exercised, this discretionary choice must be made before the development lease award, and therefore before construction begins.¹⁵ At the \$24 per square foot rate, forgoing each 100,000 square foot increment would save the government \$2,400,000 in annual lease payments.

Appendix II shows the many milestones of the space acquisition project since inception, as well as the expected dates of completion of future tasks.

Bid Protest

On June 30, 1997, a formal bid protest was lodged with the General Accounting Office by PTO’s current landlord, also an offeror on the PTO space consolidation project. The bid protest alleged that: (1) the SFO provisions were unduly restrictive and exceed the government’s needs in that they effectively limited competition to new buildings, (2) offerors must bear the costs of compliance with all environmental and infrastructure requirements before the environmental impact statement for the chosen site was issued in *draft* form, (3) the \$88 million build-out allowance violates funding limitations established by the Congress in approving PTO’s prospectus, and (4) the government’s imposition of \$88 million for build-out costs, in the absence of any consideration of existing build-out costs, unduly prejudiced existing buildings and violated the sole source requirements of the Federal Acquisition Regulations (FAR). On September 25, 1997, the Comptroller General dismissed the protest as untimely because the protestor knew of

¹⁴ SFO No. 96.004, at Section D, p. 8.

¹⁵ SFO No. 96.004, Section A.2.4., p. 2 of 30.

the SFO provisions before the Phase I submissions, yet did not challenge the provisions at that time.¹⁶

PTO's Government Corporation Legislation

In April 1997, the House of Representatives passed a bill, H.R. 400, that would turn PTO into a performance-based organization (PBO). Under the legislation, PTO would become a government corporation, and certain technical changes to the patent process would be made. In July, the Senate responded with S. 507, the Omnibus Patent Act of 1997, which incorporates many of the provisions contained in H.R. 400.

Under the proposed PBO legislation, PTO may acquire, manage, and dispose of real and personal property as it considers necessary,¹⁷ and would be expressly exempt from the Federal Property and Administrative Services Act of 1949¹⁸ and the Public Buildings Act.¹⁹ If PTO attains PBO status, the agency could be completely free of departmental and GSA oversight of its lease development and other procurement activities.

¹⁶ *Matter of the Charles E. Smith Companies*, B-277391, Sept. 25, 1997.

¹⁷ S. 507, 105th Cong., 1st Sess. §§ 112 (c)(6) through (12).

¹⁸ Federal Property and Administrative Services Act of 1949, 64 Stat. 583 (codified as amended at 40 U.S.C. § 471 *et seq.*).

¹⁹ The Public Buildings Act, Pub.L. 86-249 (codified as amended at 40 U.S.C. § 601 *et seq.*).

OBSERVATIONS AND CONCLUSIONS

I. PTO Should Continue with the Space Consolidation Effort

Many of PTO's justifications for this space consolidation lease are valid. PTO is currently housed in 18 separate (16 office and two warehouse), non-contiguous locations within the Crystal City complex in Arlington, Virginia. Some of these buildings are almost 30 years old, and many do not comply with the latest municipal fire codes and the Americans with Disabilities Act.²⁰ In addition, PTO's current configuration of disparate and disconnected building spaces is inefficient. Finally, the government should benefit from less expensive leased space upon completion of the consolidated PTO facility.

A. Justification for the Procurement Is Valid

PTO has justified the necessity for this procurement in several ways. PTO would benefit from modern, contiguous space that is compliant with the ADA and municipal fire codes and is less expensive than the short-term leased space it currently occupies. After careful review of PTO's current facilities and plans for its future facilities, we agree with the justifications supporting the lease space consolidation. Most of PTO's justifications for the space consolidation focus on future economic savings and efficiencies, and include the following:

- Most of PTO's current leased facilities in Crystal City are in need of alterations to meet fire, safety, and handicapped accessibility guidelines.
- Locating the various PTO technology groups in physical proximity to one another would reap benefits through more efficient operations, as compared to the current dispersion of groups and facilities among PTO's current 18 facilities.
- Significant growth in the number of patent and trademark applications has greatly increased PTO's workload and, therefore, its staffing needs, and the agency does not currently have the space to meet future expansion needs.

²⁰ The ADA prohibits discrimination on the basis of disability in employment, programs, and services provided by state and local governments; goods and services provided by private companies; and in commercial facilities. Signed into law on July 26, 1990, the ADA contains requirements for new construction, alterations or renovations to buildings and facilities, and improving access to existing facilities of private companies providing goods or services to the public. The ADA also covers effective communication with people with disabilities, sets forth eligibility criteria that may restrict or prevent access, and requires reasonable modifications of policies and practices that may be discriminatory. However, at the time of our review, PTO had not studied exactly what the space implications were of the ADA requirements on this procurement, nor could it quantify all the ways in which its current facilities failed to comply with the ADA. However, we were shown examples of non-compliant conditions, such as narrow aisles in the public search room and in the examiners' shoes (patent examination files).

- Long-term cost savings should be realized because current leased space, which is procured through separate, non-competed and piecemeal leases, is more costly per square foot than the target of \$24 per square foot that PTO is projecting for its new facility.
- PTO employees and customers should have improved physical access both to the facility and within the public search areas.

We find these justifications to be valid. PTO has a growing workload and is currently occupying noncontiguous space that is operationally inefficient. Also, PTO's current space is not in compliance with current municipal fire code, safety, and ADA requirements. Given that PTO's consolidation lease meets the congressionally authorized rent of \$24 per square foot, the new lease should be less expensive per square foot than the space it is currently occupying. PTO is paying an average of approximately \$31 per square foot for its office space in rental and fees to GSA. GSA, as the government lessee, pays the current landlord an average of \$25.78 overall for the PTO facilities. In addition, the new facility should promote the collocation of various working groups, thereby improving efficiency and productivity.

B. PTO Is Managing Many Aspects of the Space Consolidation Project Well

PTO is managing many aspects of the lease development contract well. Communications between PTO and GSA appear to be well-established and open. We believe the SFO demonstrates a great deal of thoughtfulness and a creative, solid design for the two-step process used in procuring the leased facility.

The use of the two-step procurement process also appears to be working well for PTO. Although the field was narrowed by only one offeror (from five to four) in progressing from Phase I to Phase II, the separation of selection criteria between the two phases conserved the government's resources in the evaluation process.

For example, Phase I evaluation criteria emphasized fundamental issues, such as site location and availability of financing. These represent critical "go/no-go" decision points that can be used to screen out offerors who have little chance of winning the project. Both the offerors' and the government's resources, therefore, are conserved for the more competitive Phase II, where the criteria focus is on the design and utility of the proposed facility.

Although we believe that the procurement process used to obtain the leased space can be effective and efficient, we are concerned that certain critical milestones are late, increasing the project's cost and schedule risk. Principal among these is the current unavailability of a detailed space plan and a build-out specification known as a "Program of Requirements" (POR).

In their responses to our draft report, the Department, PTO, and GSA all agreed with our recommendation that the PTO lease development project should continue. PTO emphasized its need to acquire more efficient space and to lower its costs in that the lease rate projected for the new or renovated facility is expected to be lower than that of the current collection of leases. The Department stated that with all of PTO's current leases expiring in the 2000-2002 time frame, this is a unique opportunity to consolidate PTO's operations. The Department believes that delaying the procurement would cost the government millions of dollars in both non-competitive lease extensions and in potential protests from the participating bidders.

II. PTO Needs to Finalize Its Space Planning

While PTO has justified the overall need for new facilities and prepared a draft Space Allocation Plan (SAP), it has not finalized its space requirements. Currently, PTO leases approximately 1,899,775 rentable square feet, of which approximately 1,704,190 is occupiable. The space requirements specified in the SFO are for up to 2,386,940 rentable square feet and 1,989,116 occupiable square feet. Therefore, PTO is seeking an increase of up to 487,165 rentable square feet (a 25.6 percent increase) and an increase of 284,926 occupiable square feet (a 16.7 percent increase).

Although we believe that PTO can justify its requirement for all 1,989,116 occupiable square feet of space, we are concerned that it has not made space planning more of a priority and that it may not have a final Space Allocation Plan (SAP) in time to complete its interior design specifications, or POR. In addition, PTO has not fully considered its future reengineered and automated systems environment. Initiatives that should reduce PTO's near and long-term space needs—primarily automation initiatives—have not been fully factored into its space requirements projections, although they could have a substantial impact on PTO's needs.

A. PTO Has Not Finalized Its Space Allocation Plan

The SFO provides for the lease development contract to be awarded based on the developer's design of the building shell alone. The government is required to issue the interior design, or POR, upon lease award.²¹ PTO is currently finalizing its space use planning to determine its requirements for the various groups and functions necessary to accomplish its mission. It now has a draft Space Allocation Plan. However, we are concerned about PTO's delay in finalizing its precise space needs. The SAP is a critical element in PTO's effort to develop the POR, without which the lease award must be delayed. As of this writing, seven months before lease award, PTO has not finalized its ground-up assessment of its requirements.

There are two main reasons PTO has not completed its space planning. First, the build-out plan has not been a priority because PTO believes it can turn back any unneeded space to GSA. Second, PTO has still not reached an agreement on individual employee space needs with the largest of its three unions.

²¹ SFO No. 96.004, Executive Summary, para. 4, p. ii of ii.

1. PTO believes it can turn back unneeded space to GSA

When awarded, the lease will be a contract between GSA and a developer/lessor. PTO will have the right to occupy space through a subsidiary agreement with GSA. PTO representatives believe that they will be able to turn back any unneeded space to GSA in accordance with section 101-17.302 of the Federal Property Management Regulations (FPMR).²² This FPMR section, "Procedures for Agency-Initiated Relinquishment of Space," provides that an agency occupying standard, commercial, GSA-controlled office space may, at no cost to the agency, turn all or a portion of that space back to the GSA with 120 days' written notice unless the agency is responsible for building operation and or maintenance, in which case six months' notice is required.

PTO cites this FPMR regulation as providing a "safety net," which will allow the bureau to lease enough space to fulfill its mission, while at the same time ensuring that it will not be trapped in a too-large facility with vacant space. GSA is also unconcerned because any space turned back by PTO would be marketable because it would be among the newest office space in the Washington, D.C., metropolitan area, located on an attractive campus setting, and close to the metrorail system. Both GSA and PTO believe there is relatively low risk of the government retaining vacant space in the new facility.

It should be noted that the FPMR was issued in 1991 as only a temporary regulation. It was published in the Federal Register on August 26, 1991, and was effective for one year. Even though GSA has not issued a replacement regulation, both GSA and PTO believe section 101-17.302 continues to be a possible mechanism for turning back unneeded space.

However, it should be noted that the FPMR is not fully applicable to this type of lease development. The FPMR is best applied to moderately-sized, standard office space, without special uses. Even a partially vacant PTO facility could be difficult for GSA to re-lease for three reasons. First, the sheer size of the new facility would put GSA at considerable risk if PTO suddenly vacated a large block of space. GSA may be hard pressed to find tenants for such a large facility, especially with government downsizing expected to continue. Second, parts of the new facility will be state-of-the-art offices conceptualized to support a high degree of automated information technology and other special purposes. Lastly, some facilities, such as the patent public search room, could be less marketable once they are customized specifically for PTO.

In other words, the safety net of returning space to GSA is complicated by the sheer size of the space itself, the risk that a new tenant would be unable or unwilling to pay for high-technology

²² 41 C.F.R. § 101-17, Assignment and Utilization of Space, Federal Property Management Regulations (FPMR) Temp. Reg. D-76, 56 Fed. Reg. 42,166 (1991). Hereinafter referred to as FPMR.

upgrades to the building, and the unmarketable nature of customized features of the PTO facilities.

Because of uncertainty about the applicability of the FPMR section, PTO and GSA should arrive at a negotiated agreement detailing the rights and responsibilities of the agencies in the event that any of the new PTO leased space needs to be turned back to GSA. See page 36 for a further discussion of space issues related to the agreement with GSA.

2. Not all PTO union agreements are in place

PTO currently has approximately 6,458 employees, including contractors, of which 4,244 are represented by one of three unions. The Patent Organization Professional Association (POPA) represents 2,251 patent examiners, the National Treasury Employees Union (NTEU) Chapter 243 represents 1,762 support personnel, and that union's Chapter 245 represents 231 trademark examiners. The amount of office space allocated to each employee has been a principal working condition issue in discussions between the unions and PTO. PTO has reached agreement with NTEU Chapters 243 and 245 to use a uniform allocation of 120 square feet to all employees. While this agreement represents a significant step forward, NTEU Chapters 243 and 245 represent less than half (1,993 of 4,244) of PTO's union employees. PTO is still pursuing a space agreement with POPA.

A major consideration is the so-called "Ross Award," named after the arbitrator who arrived at a work space-related decision in 1983. Pursuant to the Ross Award, "the goal of [PTO] shall be to provide equivalent [patent] examiners offices to examiners of equal grade and signatory authority," including that "all examiners and classifiers, grades 13, 14, and 15, shall be provided with private offices of approximately 150 square feet."²³ (Emphasis added.) POPA points to the goal of 150 square feet for senior union members as a working condition standard. Using this standard in PTO space planning, senior examiners would occupy individual offices, and junior examiners would be "doubled up," two examiners to an office. This plan would result in less overall space taken by the workforce even though each individual office would be 30 square feet larger. Support staff would occupy cubicles located in the "bullpen" open area space.

By contrast, PTO management has proposed a uniform 120-square-foot individual office for virtually all employees, regardless of rank. This is known as the "universal grid" concept. A standard 120 square feet of office space would be allocated to each occupant of an individual office. This size standard would apply to PTO management personnel and patent and trademark examiners alike, although some managers would have an attached 120-square-foot meeting room.

²³ Case #83 FSIP (Federal Service Impasse Panel) 89, Jerome Ross, Arbitrator (1983).

Support personnel would continue to occupy open bullpen areas and cubicles. It is this universal grid to which NTEU Chapters 243 and 245 agreed.

Absent an agreement on the amount and use of space with all three unions, PTO cannot finalize its interior space requirements and develop the POR. Since the POR is a contractual condition precedent, this may delay the lease award, resulting in higher costs to the government (see page 30).

We have determined that, by PTO's internal schedule, the effort to finalize its internal space requirements is more than a year behind schedule, although that earlier schedule was "padded" to allow time for delays. Now, however, there are only seven months remaining to finalize the SAP and develop the POR. While this appears to be a great deal of time, it may prove insufficient for a project of this magnitude. If PTO misses the interior space requirements deadline, the consequences will be costly because PTO's space planning and the POR will not be completed by the scheduled October 1998 lease award.

B. PTO Has Not Properly Considered Certain Variables in Its Space Planning

There are several other key variables that PTO has not adequately considered in defining its space requirements for the new leased facility. These variables include (1) the beneficial effects of its reengineering and automation initiatives on space needs, (2) "work-at-home" programs, currently in process with the trademark unit, which could be expanded to patent examinations, and (3) vacant space currently leased by PTO.

1. PTO's requirements ignore reengineering and automation initiatives that could reduce its space needs

PTO has not taken into account the effect of its own reengineering and automation initiatives that could substantially reduce its space needs in two ways: (1) greater efficiencies could be gained through increased productivity, thereby flattening staff growth projections; and (2) a reduction in PTO's paper files, which now occupy some 163,000 square feet. While PTO has acknowledged that there will be improvements in quality of work and service to customers as a result of these reengineering and automation efforts, it has not yet recognized the benefits of these efforts, which could significantly reduce the amount of space required in the new facility.

a. PTO anticipates future reductions in space needs through reengineering

PTO has completed the design of reengineered patent and trademark business processes, which are expected to have a substantial, long-term effect on PTO's space requirements. The patent target business process was published by PTO in November 1995, and the most current trademark target design concept of operations was completed in fiscal year 1996. These documents describe

conceptual, yet attainable, business processes that rely heavily on information technology to achieve what PTO calls “dramatic improvements” in products and services.²⁴

In an attempt to quantify the savings that may be achieved through its reengineering efforts in the patent area, PTO commissioned a report by an information technology contractor. Although this report was never published beyond a preliminary draft dated October 4, 1996, it remains the most detailed study of efficiencies to be gained through PTO reengineering.²⁵ While this report suggests significant savings in costs and full-time employees from full reengineering implementation, PTO questions these savings projections. Nonetheless, PTO does agree that its reengineering initiatives will achieve significant savings in terms of cost, full-time employees, and space. However, PTO has not quantified its projected savings and has not factored any such savings into its plans for the new facility because the bureau does not believe that benefits will be realized until after 2001. We believe, however, that this October 4, 1996, draft report, which we refer to as the “draft performance analysis,” highlights some of the projected savings made possible from reengineering initiatives and should be taken seriously.

In this draft performance analysis, the contractor estimated substantial PTO staff and dollar savings from a fully deployed patent reengineering project, including savings of more than 2,400 full time employees by fiscal year 2006. While PTO does not agree with these projections, it did agree that completion of this initiative will have a substantial and permanent effect on cost, space, and number of full-time employees.

The draft performance analysis projects that approximately 5.4 percent of PTO’s patent staff may be saved by fiscal year 2001, as a result of implementing the patent reengineering process.²⁶ If these staff savings were applied to PTO’s latest projection of patent staff for fiscal year 2001 of 5,549, approximately 300 patent examiners and support staff personnel would be saved as a result of implementing the patent reengineering process. Assuming an average office size of 191 square feet (including circulation and support space), 57,000 square feet of space would be saved. While this is not by itself a significant amount of space saved, this example demonstrates the importance of planning and incrementally measuring the effect of PTO’s reengineering and automation efforts on its space requirements. Any small changes in the quantity of space can eventually cause a

²⁴ United States Patent and Trademark Office, *PTO Strategic Information Technology Plan for Fiscal Years 1997 - 2002*, at EO-22 (May 1997).

²⁵ United States Patent and Trademark Office, *Patent Transition Phase Economic and Performance Analysis (DRAFT, October 4, 1996)*.

²⁶ The draft performance analysis calls for a potential staff reduction of 2,425 employees by fiscal year 2006. We use the more conservative figures for fiscal year 2001 in this analysis because PTO is scheduled to begin occupying the new leased facility in that year.

significant cumulative effect on its requirements for the build-out of the facility. For instance, a savings of 57,000 square feet represents a lease cost savings of \$1,368,000 (57,000 square feet multiplied by \$24 per square foot) each year, or a total of \$27,360,000 over the 20-year life of the lease. This estimated cost savings of \$1,368,000 is one example of the potential savings that may be achieved from substantial implementation of the patent reengineering and automation efforts.

The types of savings that may be achieved are exemplified by the Patent Application Management (PAM) system. The PAM system concept of operations was created to provide PTO with the ability to process patent applications electronically, rather than manually. PAM includes a number of subsidiary projects intended to minimize the frequency that examiners and clerical personnel will have to physically handle a given application. By maintaining the application in electronic form, the application file can be stored, examined, and transferred from one process station to the next electronically. In this fashion, time in the examination phase is minimized and transit time is virtually eliminated. PTO believes that PAM will improve the efficiency of the patent review process. PTO's Strategic Information Technology Plan, dated May 1997, indicates that PTO plans to begin developing PAM in fiscal year 2000 and begin incrementally deploying it in fiscal year 2002, one year after the new leased facility will begin occupancy. PTO has not yet planned for any decreases in the need for space in the new facility as a result of the future deployment of PAM.

In addition, PTO expects its Automated Patent System (APS) image and text search systems and data bases to support paperless searching by fiscal year 2001. Nevertheless, PTO still plans to retain in excess of 45,000 square feet of paper files. Although the examiner shoe cases will not move to the new facility, the patent classified collection will be removed from the public search room and retained in paper files.

PTO is planning to retain 45,000 square feet of file space for hardcopy patent application files because the PAM system and electronic filing will not be available until after the new leased facility will begin occupancy. Once the APS, electronic filing, and PAM systems are eventually deployed, we believe that even this remaining 45,000 of space can be saved. Although PAM will not be ready for the initial phases of construction, PTO should plan for the eventual elimination of this space requirement.

We believe that even if these systems are only partially successful in reducing the time and paperwork in the patent review process, this reduced effort should be reflected in fewer employees, fewer paper (hard copy) files, and therefore less space.

b. PTO must overcome constraints on the full deployment of its reengineering initiatives

PTO representatives claim that many of these reengineering initiatives will not be fully deployed when the new facility is occupied. Although the benefit of these systems are understood and reductions in space requirements estimable, PTO contends that the benefits of these systems will be unavailable until after the space consolidation is complete. PTO also resists incorporating most of such projected space savings into its construction plans because it claims it is not known when or even if the reengineering and automation initiatives will actually be implemented due to budget fluctuations.

For example, PAM is not scheduled for deployment until fiscal year 2002, and the pilot project is on hold awaiting the restoration of \$2 million in funding cut by the Congress under the Omnibus Budget Reconciliation Act of 1990. Moreover, some patent attorneys representing inventors and PTO's union employees are opposed to PAM's implementation: the patent bar supposedly because its on-line patent application filing process may allow individual inventors to avoid legal representation in initial filings, and the unionized patent examiners because of the possibility of more rigorous productivity standards. Finally, PAM faces major technical challenges. Since PAM is envisioned as an on-line patent application filing system, security is one of several concerns. Patent applications require secrecy in order to protect the underlying technical innovation.

Using PAM as an example, PTO management argues that the benefit of the various reengineering projects should not be factored into its plans for the new leased facility because the space savings will not be realized until 2003. We disagree. We believe that the technical challenges are not insurmountable, and that PTO should program employee and space savings into its space plan before the final dimensions and interior design of the new leased space facility are finalized. PTO is devoting significant resources to its automation efforts. For instance, in fiscal year 1996 alone, PTO obligated \$71 million on information technology capital acquisitions. In fiscal year 1997, it awarded a \$511 million task order contract spanning five years for reengineering efforts, and issued an interagency agreement and subcontract for a \$10 million, four-year system security design effort. Moreover, PTO is planning to spend more than \$1 billion for information technology, from systems design, acquisition, operations, and maintenance over the next five years. Given this level of spending by PTO for reengineering and automation, we believe that the \$2 million required to launch the PAM pilot should be available within the bureau's existing budget. Furthermore, PTO should work with the patent bar, its unions, and the public to overcome resistance to electronic filing of patent applications. The data security issues and other concerns will need to be resolved in a variety of ways, such as (1) implementing state-of-the-art security technology, (2) educating the public, and (3) successful partnering and negotiation with its employee unions.

As for the elimination of paper files, PTO cites resistance to automating the examiners' shoes and public search files from PTO's unions, the public, and patent attorneys as the reason that the paper files may not be completely eliminated. Although PTO has seen growing interest by many patent attorneys in electronic patent searching, many other patent attorneys and other members of the public would like to retain the paper files.²⁷ This is due to a preference for paper file searching over using the APS. Also, foreign patents are not expected to be on APS for another two years. However, expecting considerable progress toward automation by 2001, PTO is planning to convert most, but not all, of its paper search files to an electronic format in time for occupancy of the new lease facility.

2. Trademark work-at-home pilot project could reduce PTO's space requirements

PTO has been researching the possibility of a "work-at-home" program for its trademark examiners. A patent examination work-at-home program is not currently being considered because of security concerns. While trademark applications are a matter of public record at the point of filing, patent applications are proprietary and must remain secret. PTO officials state that this could restrict the patent examiners from bringing work home.

PTO's trademark business is piloting a work-at-home program, with a stated fiscal year 1999 goal of having 80 attorneys working at home up to 60 percent of their time.²⁸ Initial results of the pilot project, which covers electronic information storage and on-line retrieval and search, suggest that the technical problems are manageable. There is great potential to reduce PTO's space requirements if this work-at-home pilot is approved for full implementation, and if other PTO business areas are also considered for this program.

While the 231 trademark examiners account for only 3.6 percent of PTO employees, the space needs for trademark examiners could be substantially reduced before PTO takes possession of the planned facility. PTO officials have stated that people who work at home 60 percent of their time will share offices when actually at the PTO facility. This means a savings of at least 40 offices for those 80 people expected to participate in the work-at-home program by fiscal year 1999. PTO could save even more space by fully implementing this work-at-home program, and potentially moving to a "hoteling" concept of space usage, which is gaining in popularity in corporate

²⁷ *Official Gazette of the United States Patent and Trademark Office* notice, dated January 7, 1997, announcing a public meeting to discuss options for "relying on less paper."

²⁸ United States Patent and Trademark Office, *Fiscal Year 1999 Secretarial Corporate Plan* at 32 (July 1997).

America.²⁹ If this concept is also to be used on the patent side of its operations, PTO will have to address security issues by implementing state-of-the-art data security technology.

However, even if the patent examiners cannot participate in the work-at-home program, the reduction in space from the trademark staff's participation is still advantageous. For example, assuming the work-at-home program is fully implemented in the trademark area by fiscal year 2001 and there is no growth from the current level of approximately 240 trademark attorneys, 120 offices would be saved from the attorneys' sharing offices while at PTO. Thus, assuming an average office size of 191 square feet, the work-at-home program in the trademark area would save approximately 22,920 square feet of space by fiscal year 2001. This translates to \$550,080 lease cost savings each year, or \$11,001,600 over the 20-year life of the lease. Again, our estimates of cost savings are subject to changes in the underlying assumptions, but they demonstrate why PTO should factor in savings from its work-at-home initiatives in its space planning requirements.

3. PTO paid rent on vacant space

For approximately eight months, from March to October 1997, PTO had a large inventory of vacant space that was inappropriately set aside for a reorganization of several patent groups by industry sectors, in advance of congressional authorization. The renting of this space was coordinated with the Department prior to the contemplated industry sector reorganization. Before it was implemented, the Congress advised PTO to suspend the reorganization because it had not been authorized. As a result, PTO carried more than 73,000 occupiable square feet of vacant space for approximately eight months. The total cost of proceeding without approval was almost \$1.5 million because PTO paid an average of \$30 per square foot to rent this vacant space. This space is currently occupied by the patent examiners, and is no longer vacant.



²⁹ In combination with concepts such as "remote employment" or the "virtual office," hoteling includes any working arrangement in which employees perform some significant portion of their work at a location other than their employer's central office, usually at their own home. With hoteling, companies save space by not assigning permanent space to remote employees in the central office, but rather having them share offices and conference space as necessary when on-site. Such space is assigned to them by reservation, much like a hotel. Corporations that have gone to these combinations have reported increased productivity, reduced costs, and increased job satisfaction.

PTO Needs to Further Justify the Consolidated Space Project Size — Resolved

Our draft inspection report was issued on December 23, 1997 and included two significant findings not discussed above. First, we concluded that PTO had not prepared a detailed space plan, jeopardizing the lease development project. Absent a PTO space plan to evaluate, we used the now-expired FPMR to develop an estimate of the space required by PTO. Based on our FPMR model, we recommended in the draft report that PTO prepare a detailed space plan and consider forgoing at least one lot of 100,000 square feet of space.

Second, we determined that PTO should incorporate reengineering space savings into its space plan. This primarily included the reduction of PTO's paper files, particularly the hard copy examiner search files located in the "shoe" cases and pre- and post-exam files. According to PTO's estimates, these paper files totaled 163,000 square feet of space.

In response to our recommendation that PTO prepare a detailed space plan of its space needs, PTO submitted a draft "Space Allocation Plan" (SAP) dated October 1, 1997. Until this submission, we were unaware of this space plan. We understand this document approximates PTO's final expected facility, but is still in draft form.

Based upon our analysis of the draft SAP, we have dropped the recommendation previously included in our draft report that PTO consider forgoing at least 100,000 square feet of space. We have reviewed the SAP and looked at PTO requirements for office space, which includes support space (conference rooms, coffee rooms/pantries, file space and storage) and circulation. This space also included computer systems space which we did not evaluate because there is no comparable FPMR model. The draft SAP employs PTO's grid concept, whereby all union patent and trademark examiners will receive 120 square foot offices, as will virtually all of PTO's managers, although some managers will also receive 120 square foot meeting rooms. Lower grade personnel, both union clerical and non-union personnel, will occupy 60 to 80 square foot cubicles. Based upon the draft SAP, PTO will still need the full 1,989,116 occupiable square feet of space required by the SFO, despite PTO's use of the grid concept.

We believe that PTO's draft SAP is a reasonable estimate because it develops its space requirements from the bottom-up, considering the individual requirements of each major group within the bureau, and extending these requirements by the number and function of personnel employed within that group. By comparison, the FPMR model we employed simply extended average space allocations by the number of employees projected to be employed in 2001, without regard to the actual space that function or discipline may require.

Other Space Consolidation Concerns

We also recommended that PTO reach agreement with its unions on space-related issues in advance of the lease development award, to which the Department agrees. Currently, PTO has reached an agreement with NTEU's chapters 243 and 245, representing 1,993 out of 4,211 union employees. As of this writing, POPA is pursuing an administrative law appeal to the Federal Labor Relations Authority, charging that the issuance of the SFO, without prior negotiation of facility design with POPA, constitutes an unfair labor practice. We encourage PTO to continue its efforts toward concluding its union discussions as soon as possible.

PTO also addressed our recommendation that it assess the impact of its reengineering initiatives on the size of the new leased facility and factor those estimates into the bureau's space requirements plans. PTO has responded that it has, in effect, taken the space savings associated with the universal grid concept and some portions of reengineering, such as the elimination of paper search files for patent examination. In addition, PTO argues that one of the most important reengineering initiatives, electronic patent filing, or PAM, will only begin implementation by 2001, and will not be fully available until 2003, after the new facility will have been fully constructed. Finally, PTO responds that the steady increase in patent and trademark filings since the beginning of the space consolidation effort will see the number of patent and trademark applications double within the 20-year lease term. PTO believes it will only be able to remain within the 1,989,116 occupiable square feet approved by the prospectus by implementing the reengineering initiatives, without which the bureau would run out of space because of the steady growth in patents.

The Department responded that PTO has appropriately incorporated its reengineering initiatives into its overall space requirements, and that many reengineering initiatives will not yield space savings until after the facility is to be constructed. If the space savings are realized at a later date, the Department maintains that this space can be returned to GSA. In addition, the Department cautioned against building a facility which is too small to meet PTO's needs.

Finally, with regard to the vacant office space, PTO responded that this space was originally planned to be rented as expansion space. Only after the leases were in process did PTO attempt to reorganize several of its patent groups by industry segment, a move which was not authorized by the Congress. Due to this controversy, the space sat vacant for approximately eight months. The space was occupied by patent examiners on October 31, 1997, and is no longer vacant.

In the draft report, we were concerned that PTO did not reconcile its vacant space on hand to its overall requirements and may not have needed all of the space included in the SFO. However, the draft SAP developed the bureau's requirements using a bottom-up approach, obviating our concern about the vacant space as it relates to space planning. We do remain concerned, however, that PTO proceeded with its reorganization without congressional authorization, resulting in the waste of funds for rent payments.

III. PTO Build-Out Plan Requires Risk Management

The PTO/GSA procurement strategy and the SFO provide for an allowance of \$88 million for build-out of the shell. To accomplish the build-out, PTO must prepare a detailed program of requirements describing its planned space utilization. The POR is due to the successful offeror upon lease award and delay in its issuance could in turn delay the entire build-out, resulting in additional costs to the government. In addition, the nature of the build-out could also cause the government to incur additional costs because there was no ceiling on costs in the contract.

A. PTO's Build-Out Approach Is a Result of Risk Analysis

PTO arrived at the build-out allowance approach after considering three basic approaches and, through an informal process, comparing the inherent risks of each. The three approaches are for the government to (1) completely specify the entire build-out with detailed drawings upon issuance of the SFO, (2) specify detailed price lists for all build-out items before lease award, or (3) provide for an unspecified build-out with an allowance for its completion. There are benefits and risks associated with each approach:

1. Specifying the build-out with detailed drawings

Specifying the build-out with detailed drawings is a traditional construction method, especially when the entire project is designed by the government and built under its direction. Since the detailed drawings are available in advance of construction, both the base building and the build-out can be competed among developers. In this fashion, the lowest competent bid for the entire project can be accepted by the government.

Preparing detailed specifications in advance for buildings built for lease by the federal government is also required by the procurement laws.³⁰ Although PTO and GSA have meticulously specified the requirements for the base building, the build-out specifications have been deliberately omitted.

PTO did not specify the build-out requirements because it runs contrary to its entire lease development strategy. First, in competing the lease development, PTO is seeking the latest construction techniques and design concepts from the competing developers, rather than specifying the facility itself. PTO wants the developers to consider new concepts in space design and utilization. For this reason, PTO determined that detailed drawings for the build-out would not be made available before the offerors' Phase II submission of proposals. Second, PTO is also very concerned with the likelihood that the bureau's needs will change between when the drawings are completed and the construction contract competed, resulting in numerous expensive

³⁰ 40 U.S.C. § 618(a).

change orders.³¹ GSA has agreed to this construction concept and is managing the effort on behalf of PTO.

The developers' innovation is not necessarily disturbed by government furnished specifications, however, and such specifications may serve as an expected minimum threshold. In addition, we believe that change orders are likely in any event given the SFO build-out strategy.

2. Specifying detailed price lists for all build-out items

The second method calls for the developer to bid to, or negotiate with, the government a priced list of build-out items. This process is in accordance with the FPMR.³² For instance, an above-standard door lock bought in a range of anticipated quantities would be estimated at a specific price for future installation. Prices would be developed for all items of anticipated upgrades, such as price per linear foot of molding to protect walls, upgraded lighting, and carpeting. In effect, this method develops a "menu" of priced items against which additions and deductions are calculated when the inevitable changes to the build-out occur.

PTO decided against using this method because of the cost risk associated with developing the specific price lists. In particular, PTO was concerned that by pricing out the standard and above-standard items years in advance of construction, the developers would apply price escalators to protect themselves from fluctuations in the cost of building materials and labor. PTO made an informal judgment that pricing out individual build-out phases only a few months in advance of the construction time period would save the government the added escalation. In addition, PTO still would not necessarily have any detailed build-out drawings in advance of lease award to facilitate estimating the quantity of each item required.

3. Providing for a build-out allowance for unspecified work effort

This build-out approach calls for the lease development of a building with an allowance for the physical construction of the interior. The lease payments compensate the developer for the design and construction of the facility, financed over a 20-year period. The lease rate also includes an \$88 million allowance for the build-out, which the government is financing, in part, through the lease payments. This type of build-out is common in the commercial real estate industry, where office interiors are relatively standard and costs determinable.

³¹ SFO No. 96.004, Section A.7.1 and A.7.2., p 4 of 30.

³² 41 C.F.R. § 101-17, Appendix A, Federal Property Management Regulations (FPMR)) Temp. Reg. D-76, 56 Fed. Reg. 42,166 at 42,178 (1991).

PTO favors this method because the bureau would not have to define the entire build-out until lease award in October 1998, and it believes that design flexibility is an advantage in achieving work space to enhance PTO's patent and trademark production processes. Since the remaining offeror's proposals have been received and lease award is scheduled for October 1998, PTO believes it has seven months to refine its interior build plans based on its knowledge of the rough outline of the offerors' facility designs. Because the lease is a negotiated procurement, the parties will be allowed to hold discussions before award. However, complete pricing details for the build-out would still not be available until after one of the developers is awarded the entire lease development project, and no negotiations over the build-out are contemplated.

PTO also favors this build-out process because it allows the bureau greater flexibility in making changes to the build-out once the lease development is awarded and construction of the building shell begins.

The lessor/developer is required to prepare the build-out in eight to 10 stages,³³ each of which becomes a separate work task. The developer is required, at a minimum, to provide "all necessary tenant improvements and fit-out" for the \$88 million build-out allowance.³⁴ Beyond this, PTO plans a number of upgrades above the FPMR standard. PTO is planning to finance these above-standard upgrades for improved lighting and electrical systems, office doors, windows, plastic and wood finishes and moldings, special finishes, and other enhancements with its own funds. PTO is currently budgeting \$29 million for these upgrades, including escalation. PTO is also budgeting \$25 million for new furniture in its fiscal year 1999 budget submission, two years in advance of building occupancy. These figures could be exceeded because there is no ceiling on the build-out costs.

Essentially, the build-out process is a cost-type sole-source task order construction contract nested within the lease development contract. This is so because the build-out effort will be managed separately from the building shell construction, and the final cost of the build-out is not limited by the lease payment. As each stage of the construction is complete (2 million occupiable square feet in no more than eight buildings³⁵), the developer will submit a proposal on the build-out of that stage.³⁶ Rather than obligating new funds with the issuance of work against a task order, as with a task order contract, the SFO calls for the earmarking of a portion of the \$88

³³ SFO No. 96.004, Section D.2.2., p. 2 of 22.

³⁴ SFO No. 96.004, Executive Summary, para. 4, p. ii of ii. PTO describes the "necessary site improvements" to be standard, commercial office space readily available in the commercial real estate market.

³⁵ SFO No. 96.004, Section G.1.2., p. 2 of 43.

³⁶ SFO No. 96.004, Section D.6.1.a, p. 8 of 22.

million build-out allocation against a stage of the build-out. It is not clear how the \$29 million PTO upgrade budget will be added to the mix, whether it will be commingled with the \$88 million build-out allowance or held and authorized separately.

Our concerns with the built-out method chosen by PTO are discussed below.

B. PTO's Build-Out Allowance Method Contains Considerable Risk

PTO's build-out process presents two types of risk: (1) the cost risks associated with the build-out, and (2) the schedule risk, which also can result in additional costs to the government.

1. Cost risk

a. The PTO build-out has no contractual ceiling

The single greatest cost risk associated with the build-out is that the above-standard build-out, to be financed by PTO, is not limited by a ceiling in the SFO. PTO may make numerous changes to the build-out after the lease is awarded and construction begins, thus driving up costs. We are further concerned that PTO has budgeted \$29 million for the build-out and another \$25 million in fiscal year 1999 alone for furniture, even though the new furniture will not be required until 2001, and then only in stages to match the occupancy of the new facility. GSA lacks an incentive to control PTO's build-out expenditures because under the terms of the verbal agreements between the agencies, GSA will not be responsible for the above-standard costs. Moreover, as of this writing, GSA is discussing with PTO its fee for managing the build-out process, and a straight percentage-of-cost fee ranging from 3 to 9 percent has been discussed. This means that GSA will have little incentive to minimize PTO's costs since the higher the total build-out cost, the higher GSA's fees (see page 35).

Although the overall lease development has been approved by the Congress, the above-standard build-out has not. No alterations to a lease in excess of \$750,000 may be made "unless such alteration has been approved by resolutions adopted [by the Congress]."³⁷ The Senate and House of Representatives resolutions approving PTO's lease development did not specifically authorize cost growth for above FPMR-standard build-out. It is not clear that Congress has approved of the \$29 million build-out cost growth.

The standard build-out is financed through the SFO and has a specified cap of \$88 million, which also defines the extent of GSA's liability in the build-out. In the event that GSA must take back unneeded space from PTO and find a new lessee, GSA must still pay rent on that space to the

³⁷ 40 U.S.C. § 606(a).

developer. However, since the above-standard build-out was financed directly by PTO, GSA is only liable to the developer/lessor for the value of the standard build-out costs, which are included in the lease payments. This arrangement makes the office space more marketable in terms of cost and therefore more attractive for a new tenant. Since GSA will bear the risk of taking back unneeded space from PTO, this arrangement is acceptable to GSA. However, since PTO is responsible for the above-standard build-out as a direct cost, this arrangement also puts the risk of over-building the above-standard build-out directly on PTO. PTO and GSA do not regard the congressional authorization as a cap or ceiling on above-standard items. As long as PTO has “cash and clout” it will be able to get any above-standard changes it wishes. Should PTO’s PBO legislation be enacted, PTO will have both the cash, through full use of its fees, and the clout, once exempted from the federal procurement and real property management statutes, to chart its own course. Otherwise, PTO would be limited by the funding allocated and approved by the Office of Management and Budget.

PTO should prepare a definitive POR that specifies its build-out and includes a cost estimate. This cost estimate should then be incorporated into the SFO as a contractually binding ceiling for the build-out. The definitive POR should be developed immediately so that the build-out requirements are identified as early as possible. Doing so will enhance the quality and utility of the developer’s offers.

b. Risk of contractor/developer buy-in

The lack of a detailed design may increase the build-out, and overall costs, because developers may be able to “buy in” on the base building shell and build-out portion of the project.³⁸ The \$88 million build-out allowance is financed through the lease. Any amount over that must be financed directly by PTO. Given the lack of a contract ceiling, the successful offeror may present an attractive build-out concept, but after award would have an opportunity to increase the scope, cost, and fees of the build-out because of his sole-source position.

PTO and GSA claim that the mere fact that the successful offeror is a sole-source for the build-out phase does not necessarily mean that costs will rise. They point to language in the SFO that would tend to closely manage the build-out, to the point of specific approval of subcontractors. In addition, they claim that the government would be subjected to at least the same degree of risk with established build-out specifications due to the probability of changes in the build-out. PTO and GSA say the government is not disadvantaged because the specifications would likely change anyway. Nonetheless, because of a lack of detailed build-out requirements in the SFO, the

³⁸ 48 C.F.R. § 3.501-1. “Buying-in” means submitting an offer below anticipated costs, expecting to (a) increase the contract amount after award (*e.g.*, through unnecessary or excessively priced change orders) or (b) receive follow-on contracts at artificially high prices to recover losses incurred on the buy-in contract.

government will not be able to get at least a competitively bid baseline on the initial build-out design, before any changes are made.

With a normal build-out allowance containing a contract ceiling, there is no incentive for the developer to buy in on the build-out. This is so because the government lessee will not accept the facility until it meets the minimum commercial standard for office space, that standard is understood by the developer and the government, and the entire build-out must be accomplished within the amount financed through the lease rate. In the case of the PTO facility, however, the final build-out specifications, or POR, are not known. A developer may perceive an opportunity to make additional profits through a change order process at a later date.

The SFO requires the developer to submit a space plan, design intent drawings (DIDs), construction drawings (CDs), and a cost estimate with each proposed stage of build-out.³⁹ These submissions are appropriate measures to assist the government in negotiating what is, in effect, a series of sole-source construction task orders.⁴⁰ However, since these task orders are essentially changes to the base building lease development effort, PTO should require the developer to maintain detailed cost records of its ongoing build-out effort so that PTO can monitor the developer's cost performance and make necessary adjustments to the build-out project.⁴¹

Well before negotiations with the offerors begin, PTO should (1) place an absolute contractual ceiling on the value of the build-out and (2) incorporate language in the SFO requiring the developer to maintain individual cost records for each phase, block, and stage of the build-out. By tracking the contractor's cost data to the lowest level of change activity, PTO will be better able to control build-out costs and monitor the developer's performance.

³⁹ SFO No. 96.004, Section D.6.8., p. 12 of 22.

⁴⁰ FAR 15.8.

⁴¹ FAR 15.804-2.

c. Cost risk associated with contract changes directed by the contracting officer's representative

The SFO provides for work effort and changes to the build-out to be authorized by either the GSA contracting officer (CO) or the contracting officer's representative (COR).⁴² Further, the SFO provides for alterations to be made to stages of the facility *after* government acceptance.⁴³ It is customary for a COR to assist the CO in technical matters and inspection and acceptance decisions. However, we believe the government will be exposed to additional change order cost risk if a PTO representative is allowed to authorize contract changes describing the construction and build-out. The SFO is appropriately silent as to the identity of the COR, who will be appointed after award and identified in the contract. The COR should not be a PTO representative because the developer would have multiple points of contact with government authorizing officials split between two agencies. In addition, a PTO COR may lack the necessary independence to resist unreasonable change requests.

Federal government contracts usually specify that only the CO has the authority to direct and change the contractor's work efforts. The FAR stipulates that "change orders shall be issued by the CO except when authority is delegated to an administrative contracting officer."⁴⁴ The COR's authority is typically limited to inspection and acceptance of completed work and interpretation of technical specifications. In fact, contract disputes may arise if activities of the COR, or contracting officer's technical representative (COTR) change or add restrictive requirements to the contract, resulting in a constructive change order.⁴⁵

Under the current arrangements, once the construction, including build-out, is complete for any portion of the new facility, GSA's responsibility for that task is complete. The financial responsibility for authorizing and paying for post-acceptance alterations rests with PTO.⁴⁶ We are concerned that the flexibility to initiate changes will promote waste and inefficiency on the part of PTO because it may use this ability to continually change its interior under the lease as a costly replacement for up-front space use planning. PTO should develop its space use plans as soon as possible, rather than later in the lease development process.

⁴² SFO No. 96.004, Section D.8.7.f, p. 20 of 22.

⁴³ SFO No. 96.004, Section D.8.7., p. 19 of 22.

⁴⁴ 48 C.F.R. § 43.202.

⁴⁵ Switlik Parachute Co. Inc., 74-2 BCA Nos. 17920, 17923, ¶ 10,970 at 52,209.

⁴⁶ SFO No. 96.004, Section D.8.7.g, p. 20 of 22.

d. Risk associated with incomplete specifications

There are two risks associated with PTO's lack of complete specifications: (1) the developers do not have all of the government's requirements at the time of proposal submission, increasing their risk and, potentially, the final cost to the government, and (2) change orders become more likely as corrections and/or additions to the original specifications become necessary.

1) Increased performance risk to the developers may increase government costs

Without the benefit of the POR, the developers do not have all of the government's requirements. Lacking these final specifications, the developers must assume more risk in designing their structures because they do not know PTO's individual office space requirements and details on special/joint use space. The developers are required to design a base building without knowing how the PTO components will fit into that structure. Although PTO wants a structure and interior design that will make its work flow more manageable and more efficient, it has not yet conceptualized such an interior around which the developers can design the structure.

As the offerors must assume more of the development risk, such risk is ultimately reflected in their offers through higher costs or through a cheaper building design. Since the rental rate is fixed at the authorized \$24 each square foot (plus escalation to lease award), the developers will be pressed to design more cost-effective structures for construction, but not necessarily for maintenance purposes. For example, in Amendment Five to the SFO, PTO removed the new facility's utility costs from the lease rate and made them the sole responsibility of the government. PTO representatives explained that before the SFO amendment, the utility costs were the developer/landlord's responsibility. Since PTO's employees, especially patent examiners, work varied hours, the developers had a difficult time quantifying utility costs, adding risk to the developers. To compensate for this added risk, the lease rate might have exceeded the authorized rent of \$24 per square foot. PTO's removal of the utility costs from the lease was an admission that the lease may be too risky for the developers and that PTO could better shoulder some of that risk, although possibly at an increased cost to the government.

The added risk associated with the lack of a POR is that the developers will have an incentive to cut design corners where they are able, for instance in the building's architectural and aesthetic design and in energy saving features. Some GSA representatives believe that this will result in inefficient, boxy, and unsatisfying architectural structures.

2) Incomplete specifications increase the likelihood of expensive design changes

PTO has only seven months from the receipt of offeror's proposals until the POR is due with the lease award in October 1998. Although PTO believes that a detailed POR can be prepared in this time, we remain concerned that a sufficiently complete POR is unlikely due to ongoing union

discussions and the sheer scope of the project. If PTO is, in fact, behind schedule come October 1998, it would be under pressure to issue the POR regardless of its completeness. Otherwise, PTO would subject itself to schedule delays for the overall project and additional delay costs. Similarly, the contractors are also subject to additional risk, which may cause them to inflate their initial offers on the lease development as well as the individual stages of the build-out.

In the event that the POR is incomplete or otherwise less than fully representative of the facility that PTO desires, the bureau runs the risk of entering into a number of expensive change orders. Under the oral agreement with GSA and the language of the SFO, PTO alone would bear the full cost of such changes.

It is critical that PTO complete its union discussions, finalize its space needs, and take all reasonable steps necessary to ensure that the POR is complete and ready for issuance to the successful offeror on the date of lease award. In the event that PTO cannot meet these requirements by lease award, it should consider delaying the lease award date because of the likelihood that the cost of lease rate escalation will be more than offset by the reduced risk of awarding the lease without complete build-out definition (see below).

2. Schedule risk

As discussed above, the delay or incomplete status of the POR has cost risks. In this section, we distinguish such cost risks from the potentially profound implications of a major delay in making lease award and issuing the POR. There are two types of delays: (1) delay in making lease award and (2) delays in the construction and build-out of the new facility.

a. Delay in making lease award

PTO is running the risk that the lease award will be delayed because of the need for the build-out POR. In the event that the lease award is delayed a relatively short time, such as a few weeks, there may be little or no impact on the cost of the lease facility. This is because the project is a negotiated procurement between the government and each of the four offerors. In the give and take of the negotiation process, relatively minor delays are sometimes experienced. In the event that hardships are suffered by the successful offeror, the government may escalate the lease rate by a modest factor to reflect the delayed award date.

An example of such escalation is included in the SFO price evaluation methodology to be used in evaluating each of the offers. The SFO specifies an escalation of 2.9 percent compounded annually to be used in evaluating the offers.⁴⁷ Such an escalation may be appropriate in

⁴⁷ SFO No. 96.004, Section A.18.3.b., p. 14 of 30.

compensating the developer/lessor for minor government delays in making lease award, as appropriate, at least to the extent that occupancy is delayed. In addition, PTO would be liable for the consequential continuing lease cost of its current facilities. Of course, if PTO prepares its POR for the scheduled lease award in October 1998, the government will not be subjected to additional price escalation beyond the scheduled lease award or consequential holdover lease costs, some \$45 million each year.

In the event of a major delay, such as several months, PTO runs the risk that the entire project will be scuttled. The developers are dependent upon outside financing for the construction of the new facility. If lease award is delayed for a long period, the developers may lose their financial backing and be forced to withdraw from the project. In such a situation, the government may be liable for the withdrawing offeror's proposal costs. Again, this emphasizes the need for PTO to prepare its POR in a timely manner.

b. Delays during the build-out

Another area of schedule risk lies with the build-out of the shell. The SFO describes a process of establishing a build-out project schedule, submission of cost estimates by the developer, government approval of plans, and monitoring of performance.⁴⁸ Included is a well-conceived method for measuring delays, determining to whom those delays are attributable, and providing for liquidated damages and other remedial measures. Overall, these provisions offer protection to the government against contractor delays.

However, in the event that the government proceeds with lease award without issuing the POR, these safeguards may work to the contractor's favor. The government POR issuance at lease award is a condition precedent to the developer's performance. If the POR is not issued at that time, or is incomplete to the extent that it is deficient as a planning instrument, the developer may be relieved of responsibility to perform until the POR is issued in a usable form and the delivery schedule can be reestablished. In the interim, the developer may be able to charge the government with price escalation, rent in advance of occupancy as part of liquidated damages, and the cost of maintaining an idle workforce.

There is great pressure, therefore, for PTO to issue the POR upon lease award, as planned. If the POR is issued on time but is incomplete, there is also the possibility of increased build-out costs through the change-order process.

⁴⁸ SFO No. 96.004, Sections D.2 through D.8, pp. 2 through 21 of 22.

In response to our recommendation that PTO develop an estimate for the build-out of the facility and establish this as a contractual ceiling, PTO agreed that there should be an absolute limit on the government's liability for the build-out, but disagreed that the SFO as drafted does not set such a limit. Furthermore, PTO said it would be inappropriate to include any reference to the \$29 million for above FPMR build-out items in the SFO because the government cannot guarantee that such funds will be made available or expended. Nor did PTO think it was appropriate to create a contractual obligation to commit these funds for build-out of the facility.

PTO does not agree that failure to establish a contractual ceiling would increase the project risk to the government. First, PTO argues that GSA has, in fact, established a project estimate for the build-out through the 1995 Heery International cost analysis. It was from this cost analysis that the \$88 million base build-out and \$29 million above-standard estimates were derived. We acknowledge these estimates and encourage PTO to incorporate these as contractual ceilings for the project. The Heery International estimate is very detailed and itemizes the above-standard build-out costs, the vast majority of which are for lighting, electrical, and mechanical improvements intended to enhance PTO's ability to carry out its mission (as opposed to cosmetic improvements).

Second, PTO believes the annual budget process will place adequate management scrutiny and oversight on the build-out process, ensuring that government resources are not wasted. We agree that the annual budget process is useful in ensuring that the build-out effort is not contractually authorized until funding is available. However, we believe that the contract should establish a ceiling against which funding could be incrementally provided, and incorporate contractual clauses limiting the government's liability for the build-out to funded levels. The Department also believes that the build-out method chosen by PTO and GSA is an established private-sector practice that will yield good results, and that it would be unwise to change at this late stage in the project.

Finally, PTO believes that the authorization of build-out work by stages includes budget controls on PTO and cost management controls on the developer. Specifically, PTO maintains that the cost for each build-out phase must be estimated in advance by the developer, at which time funding is provided. This results in a natural budgetary constraint. In addition, cost controls are to be placed on the developer to monitor progress against costs expended to keep the individual build-out phases within their estimate. These controls are essentially those associated with Indefinite Delivery Indefinite Quantity contracts, where individual orders are estimated in advance and monitored. While it is proper to establish budgetary and cost controls at the individual task order level, we believe that the total costs of the estimated build-out stages should be summed together and added to the contract as a cost and budget ceiling. Such a measure would add further protection against cost growth on the overall project.

As for the appointment of a PTO COR, we acknowledge that the intent of the SFO provision⁴⁹ D.8.7 is to allow changes to the facility to ensure its efficient use over the 20-year lease term. However, provision D.8.7 does not preclude PTO from empowering a second COR which may interfere with GSA's COR. Our concern is not focused on preventing PTO from making useful changes to its facility over the lease term. Rather, our concern is that PTO could appoint a second COR during the construction and build-out phase who could, concurrently with a GSA COR, give conflicting and competing work direction to the developer/lessor.

In subsequent discussions with PTO, the bureau acknowledged that it has no need for its own COR until after the facility has been constructed and lease payments commence. Further, PTO will propose language in its MOU with GSA to clarify this understanding. When PTO and GSA do execute a written MOU, PTO will include a clause restricting the bureau from appointing its COR until after the completion of construction. We agree with this course of action.

Our recommendation that developer costs be accumulated at the lowest individual task level addresses the need to monitor the developer's activities to ensure that costs from one stage of the build-out do not migrate to successive stages. We reaffirm our concern that the build-out is actually a series of sole-source construction task orders, and we do not believe that requiring competition at the subcontractor level will adequately address the government's cost risk. PTO has responded that it will discuss additional cost control measures with GSA and the Department. Based upon further discussions with PTO and the Department, we anticipate that they both will take appropriate measures to monitor the developer's build-out costs.

⁴⁹ The "provision" is a solicitation clause, in this case, in the SFO. When the contract is awarded it becomes a contract clause.

IV. PTO Has No Interagency Agreement with GSA for the Lease Project

Although the PTO lease development project represents one of the largest government office projects ever, there is no written agreement between PTO and GSA. Instead, the agencies have been managing this project through an oral agreement. Normally, on this type of project, two or more federal agencies enter into a written interagency agreement describing the rights and obligations of each agency and allocating the underlying project risk between them. We have identified several key areas of concern arising from the lack of a written interagency agreement for this lease development: (1) the undefined fee due to GSA, (2) PTO's ability to turn back unused office space to GSA, and (3) GSA's unspecified future involvement with the development project.

A. GSA's Fee Structure Is Undefined

The GSA fee structure for the lease development project has not been agreed to by the two agencies. There are three elements to the anticipated fee arrangement. First, GSA currently receives a straight 3-percent fee based on some elements of service support contractor costs (not including, e.g., source selection efforts) expended for the management of the project. Second, GSA is pursuing a percentage fee based on costs expended for the above standard build-out project management, although these terms have not yet been agreed upon. Third, GSA and PTO are discussing a sliding scale percentage fee for long-term management of the facility, based upon the value of the monthly lease payments. Although none of these fees have been defined by formal agreement, we are particularly concerned with the build-out and scaled lease payment fees, which will extend into the future. The execution of an interagency agreement has been complicated by policy changes at GSA. GSA is attempting to move toward becoming a self-funded, customer-oriented agency, but its policy considerations have not been defined or articulated to PTO.

1. GSA's fee for the build-out effort

Currently, the two agencies contemplate that GSA will manage the build-out of the cold, dark shell on behalf of PTO. In consideration for this effort, PTO and GSA are considering a fixed, percentage-of-cost fee based on actual build-out costs expended, with a fee rate from 3 percent to 9 having been discussed. Comparing these undeveloped interagency agreement terms to procurement actions for comparable services, we have two concerns: (1) there is no ceiling to the fee GSA can receive, and (2) the fee rate should be capped in accordance with the FAR, which limits the maximum fee for architect-engineering firms to 6 percent.

a. GSA has unlimited fee potential

Under its oral agreement with PTO, GSA would receive a percentage fee based on the costs incurred by PTO to accomplish the build-out. The total maximum estimated cost of the build-out has not been established as a ceiling in the contract. Since GSA's total potential fee is a percentage of costs which are not capped, the arrangement has a result similar to a cost-plus-percentage-of-cost contract, which is expressly prohibited by statute.⁵⁰ We find the structuring of GSA's fee in this fashion to be disturbing because by basing GSA's fees on total uncapped costs, it seems to remove any incentive for GSA to monitor costs or rein in over-designing or overbuilding by PTO.

b. GSA's build-out fee should not exceed the statutory limit for contracts

PTO and GSA are discussing the terms of their interagency agreement, including GSA's build-out fee rate, for which values of between 3 to 9-percent of estimated costs have been discussed. By statute,⁵¹ fees for architect-engineering contracts "shall not exceed 6 percent of the estimated cost of construction," to include program management.⁵² We believe it inappropriate for PTO to pay fees to another government agency that would be illegal to pay to a private contractor.⁵³ PTO has not yet formally agreed to any fee to GSA for managing the build-out. PTO should limit the fee it pays to any party to one that is within statutorily prescribed rates.

2. GSA's scaled fee for the term of lease

In its move toward becoming a profit-oriented organization, GSA has considered charging PTO a fee based on the value of its lease payments to the developer. The purpose of this fee is to finance GSA's lease management on behalf of PTO. GSA and PTO are contemplating the payment of a fee that is .25 percent of the lease value as reimbursement to GSA for managing the lease. This payment rate may be scaled up or down in recognition of the age of the facility and the possibility of PTO's turning unneeded space back to GSA. Issues complicating this arrangement are that GSA does not yet have a final policy regarding its business methodology and OMB would need to approve such an arrangement. Such a fee would make business sense if GSA were responsible for

⁵⁰ 41 U.S.C. § 254(b). Cost-plus-percentage-of-cost contracts are regarded as excessive and prohibited by the government as a matter of policy.

⁵¹ 41 U.S.C. § 254(b).

⁵² 48 C.F.R. § 36.102(3).

⁵³ 41 U.S.C. § 254(b). See also FAR 15.903 (d)(1)(ii).

taking back large amounts of unneeded PTO space. This annual fee would be estimated at approximately \$119,350,⁵⁴ before escalation of the lease rate to the point of occupancy.⁵⁵

In order to properly describe the rights and responsibilities and the distribution of risk between them, PTO and GSA should execute a written interagency agreement identifying the fee policies, calculation, and payment terms.

B. MOU Needs to Address PTO's Right to Turn Back Unneeded Space to GSA

When an agency's needs change and it requires less office space, the FPMR provides for an agency's relinquishment of office space back to GSA at no cost to the agency, within 120 days of notice of vacancy, unless the agency is responsible for operation and maintenance costs, in which case GSA receives 6 months notice.⁵⁶ GSA is then responsible for filling the vacant space with another federal agency customer.

To date, the agencies' representatives have been relatively unconcerned about the lack of an interagency agreement controlling PTO's right to turn back unneeded space to GSA. PTO and GSA point to the FPMR, claiming that while they are following this regulatory framework, an agreement is in effect. However, if PTO does attain PBO status in the future, GSA's statutory and regulatory responsibility for PTO real estate transactions is not clear. We believe that as the federal government's expert in this field, GSA should continue to act as the property manager for the new leased facility.

⁵⁴ 1,989,116 square feet at \$24 per square foot multiplied by .0025.

⁵⁵ The lease rate is escalated at an annual rate of 2.9 percent from the date of congressional authorization to lease award. Since the scaled fee is based upon a percentage of the lease payment, it is also subject to escalation.

⁵⁶ 41 C.F.R. § 101-17.204 (a and b), Notice to GSA of Relinquishment of Assigned Space, from Assignment and Utilization of Space, Federal Property Management Regulations (FPMR) Temp. Reg. D-76, 56 Fed. Reg. 42,166 (1991).

C. PTO Should Continue Using GSA for the Construction and Management of the Lease Development

The Public Buildings Act specifies that only GSA may construct buildings designated for federal government use.⁵⁷ The legislative history accompanying the PTO PBO legislation specifies that the lease development project proceed undisturbed.⁵⁸ Although this language specifies that the PTO solicitation should proceed under GSA's direction, it does not specify the agencies' respective roles after lease award and during the lease period.

PTO has no institutional experience in managing the construction of a leased facility. Therefore, we believe that GSA should have a continuing role in managing the new facility's build-out and operation even if PTO attains PBO status in the future. The operation and management of real property is apart from the bureau's mission, GSA is the government expert in this field, and PTO should not be distracted by these additional responsibilities.

We believe that PTO should execute a written interagency agreement with GSA that clearly specifies the rights and obligations of each party and allocates project risk. The agreement should also specify the exact fee arrangements for GSA as the build-out manager and lease manager, and the extent to which PTO can turn back unused space to GSA. This agreement should be put in place regardless of whether PTO attains PBO status.



In response to our recommendation that PTO execute a written MOU with GSA, all parties--PTO, GSA and the Department--have agreed that this should be done. As of this writing, however, the MOU has not been executed. We encourage PTO and GSA to quickly resolve any remaining issues of pricing and service delivery. We understand that an MOU between PTO and GSA is in the late stages of development.

In addition, PTO has held discussions with GSA regarding the negotiation of a fee which would be based on a fixed percentage of the contract rent, not to exceed six percent. This fee would cover (1) lease acquisition, including management of all build-out, (2) lease administration, (3) security, (4) property management, (5) indemnification for PTO's right to turn back unneeded space upon a 120-day notice. In addition, GSA policy indicates that the fee shall be negotiated

⁵⁷ 40 U.S.C. § 601 and 602a.

⁵⁸ S. Rep. No.42, 105th Cong., 1st Sess. 58 (1997)

downward to the extent that (1) the size of the project results in economies to GSA or (2) the agency elects to accept a reduced level of services.

And finally, PTO disagreed with our position that GSA should continue to act as property manager for the new leased facility. PTO intends to request a delegation of authority from GSA to manage the consolidated facility.

V. The Department Needs to Improve Its Real Estate Management Oversight

During our inspection, we discussed the issues detailed in this report with the Department's real estate management staff. Generally, we found the Department's staff to be unaware of many of these issues before we raised them.

PTO has been granted considerable freedom in pursuing its lease development project. While aware of PTO's difficulties in obtaining OMB approval for the prospectus, for example, the Department neither aided PTO in this process nor worked to revise PTO requests that OMB found unreasonable.

We are particularly concerned that the Department has not monitored the lease development project schedule and had not reviewed the terms of the SFO prior to its issuance. Monitoring of the project schedule would have disclosed that PTO's late discussions with its unions concerning space requirements were jeopardizing the POR development and thereby the entire project schedule. Likewise, departmental officials should have reviewed the SFO before issuance and identified certain terms to be adverse to the best interest of the government. For example, the SFO does not have a cost ceiling for the build-out of the building shell.

The departmental real estate management staff needs to stay abreast of large lease and construction projects such as this and make timely comments to guide the bureaus. In this case, departmental officials should have been monitoring the progress of PTO's union discussions and gauging the implications of delays.

The Department's real estate management staff should monitor the progress of PTO's preparation of the POR and offer guidance and assistance to ensure its timely and successful preparation. The realty staff should also monitor the progress of the evaluation of the lease development proposals through to award to ensure that the process is completed as efficiently and quickly as possible. Finally, the Department should remain involved in the oversight of the leased facility's construction.



In response to our recommendation that the Department provide oversight, assistance and guidance to the PTO space project, the Department has maintained a higher level of involvement in the project, especially in recent months. The Department has assigned both real property and procurement personnel to coordinate ongoing planning activities and assist in the source selection process.

In response to our recommendation that the Department establish effective oversight policies and procedures for future lease development projects, the Department recently created Chapter 10 of the Real Property Management Manual. This new chapter describes the policy of the Department regarding any prospectus-level repair, alteration, construction or lease project for the Department.

RECOMMENDATIONS

We recommend that the Assistant Secretary of Commerce and Commissioner of Patents and Trademarks take the following actions:

1. Continue with its lease development project.
2. Finalize its detailed space requirements analysis for PTO's future needs. To take advantage of the opportunity to forgo the construction of unneeded space, this space use plan should be completed before lease award so that PTO can use the plan in its negotiations with the offerors.
3. Continue its efforts toward concluding discussions with the POPA membership union employees on work space and its configuration as soon as possible. A timely resolution of this matter will facilitate the completion of PTO's space plans in advance of the lease development award so that the bureau is able to specify the POR build-out requirements to the developer before the start of work.
4. Assess the impact of PTO's reengineering initiatives on the size of the new leased facility and factor those estimates into the bureau's space requirements plan. These estimates should reduce staffing requirements and the need for physical storage space for hard-copy patent records, to the extent these considerations have not been addressed in the October 1, 1997 draft Space Allocation Plan.
5. Prepare a discrete build-out budget before lease development award in October 1998 that PTO can incorporate into its negotiations with the developers. PTO should estimate a final cost of the build-out and specify this limit in the SFO as an absolute limit of the government's liability for the build-out. Fees should be based on the up-front proposed, not actual, costs.
6. Do not appoint a PTO representative to serve as the contracting officer's representative (COR) until construction is complete and lease payments begin for the new facility. PTO should not allow a PTO COR to have the authority to concurrently direct the contractor's work independent of the GSA contracting officer.
7. Specify that the developer/lessor must accumulate costs at the lowest individual task level before lease development award, in order to control and monitor costs during the build-out phase.
8. Execute a written interagency agreement with GSA to record the terms and conditions of the agencies' oral understandings. This agreement should specify the rights and

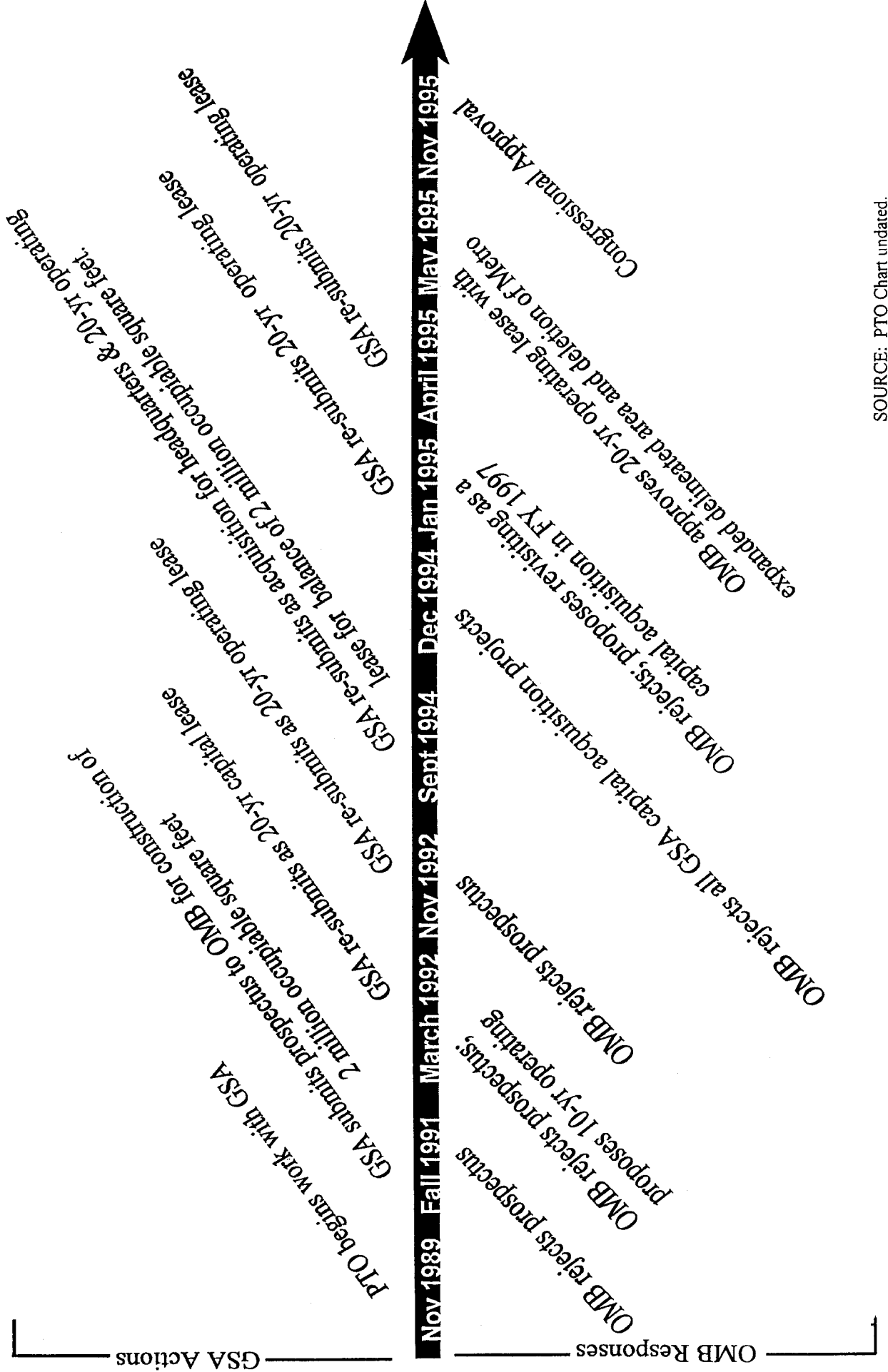
responsibilities of each agency, allocate project risk, set levels and payment terms of fees, specify conditions for turning back unneeded space to GSA, and define GSA's role in the continuing development and operation of the lease, especially in light of PTO's potential reorganization as a performance based organization. The agreement should also be cleared through the Office of General Counsel (OGC).

9. Do not agree to any arrangement with GSA in which the GSA fee to be paid is set as a percentage of costs which are not capped.

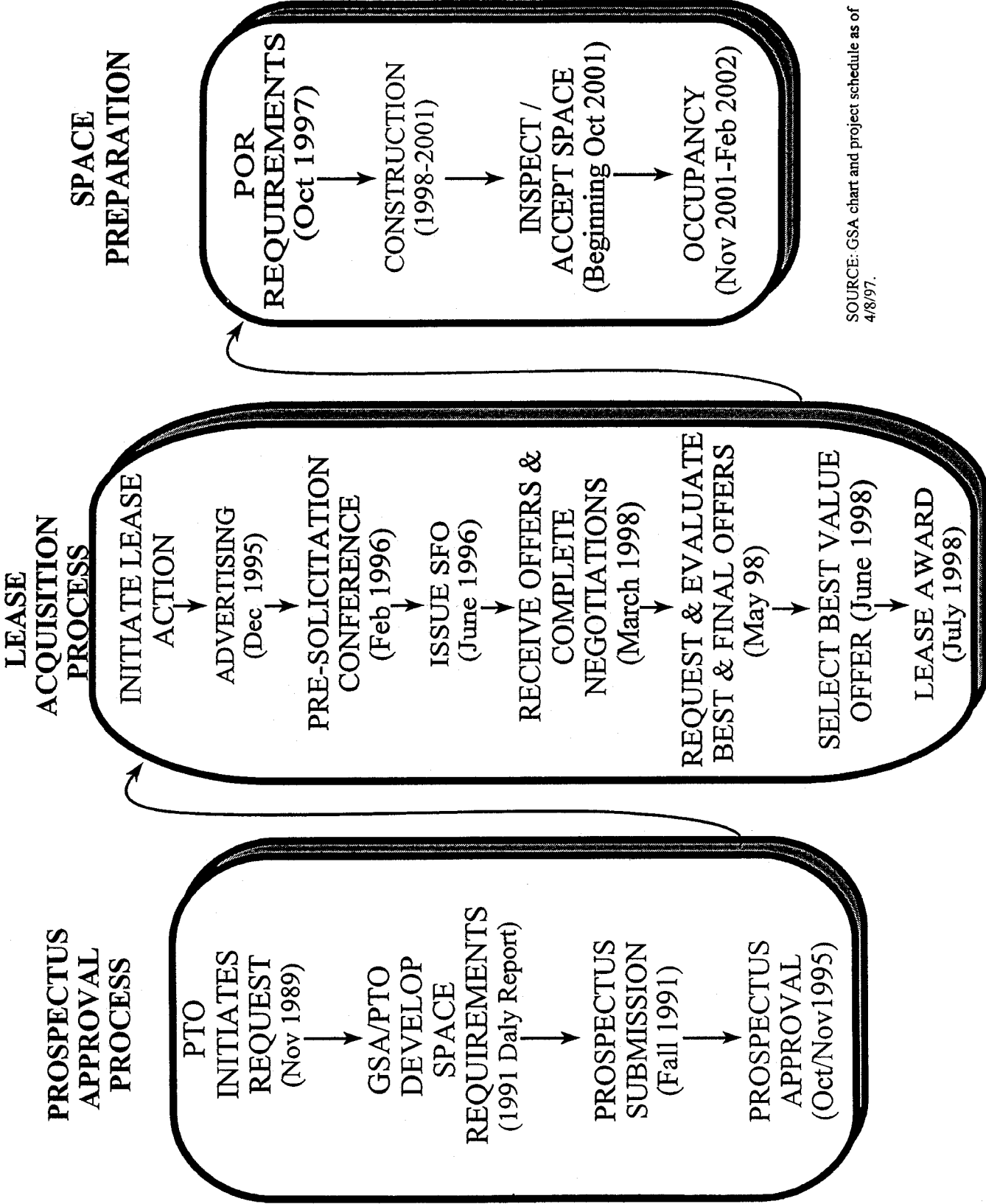
We recommend that the Chief Financial Officer and Assistant Secretary for Administration:

10. Provide oversight, assistance, and guidance to ensure that PTO completes its POR space requirements in time to avoid delaying lease award. In addition, the Department's real estate management staff and procurement oversight staff should review the terms of the SFO, lease award, and interagency agreement with GSA to ensure that the project incorporates terms and conditions that are acceptable to the Department.
11. Establish effective oversight policies and procedures for future lease development and construction procurement actions conducted by PTO or other Commerce bureaus, regardless of whether these are under independent leasing authority or under the auspices of GSA. These policies and procedures should ensure that the Department reviews and approves the project at its earliest stages through to completion.

Appendix I Space Prospectus Approval Timeline



Appendix II PTO Space Acquisition Project Milestones



See Appendix I for more details

SOURCE: GSA chart and project schedule as of 4/8/97.



UNITED STATES DEPARTMENT OF COMMERCE
Patent and Trademark Office
ASSISTANT SECRETARY AND COMMISSIONER
OF PATENTS AND TRADEMARKS
Washington, D.C. 20231

FEB - 6 1998

MEMORANDUM FOR Johnnie E. Frazier
 Acting Inspector General

FROM: Assistant Secretary of Commerce and
 Commissioner of Patents and Trademarks

SUBJECT: Draft Inspection Report, *Patent and Trademark Office:*
 Insufficient Planning is Jeopardizing PTO's Space
 Consolidation Project, IPE-9724

Per your request dated December 23, 1997, the Patent and Trademark Office (PTO) has reviewed the draft report: *Patent and Trademark Office: Insufficient Planning is Jeopardizing PTO's Space Consolidation Project (IPE-9724, "Draft Report")*. We are pleased that you agree that the PTO will benefit from the facility and that your review shows that the overall procurement strategy is sound. This important project will deliver, at a lower rental rate than we are likely to pay on a non-competitive basis at our current location, a consolidated facility that will both enhance our operations and provide more efficient, accessible space for our employees and customers.

We concur with your overall recommendations, with one minor exception. We believe that your concerns about Solicitation for Offers (SFO) paragraph D.8.7., dealing with a PTO contracting officer representative's (COR's) authority to accept post-occupancy alterations, are grounded in a misinterpretation of the SFO language (see discussion of Recommendation Six). We also think it is important to note that much more progress has been made on many of the recommended actions than is reflected in the Draft Report. Finally, we found some of the report's observations to be somewhat misstated (see Attachment A).

Our response to the eleven recommendations follows:

Recommendation One: The PTO should continue with its lease development project.

We agree. The PTO is anxious to proceed to acquire more efficient space and to lower our costs. The General Services Administration (GSA) pays the PTO's current landlords, on average, \$25.78 per rentable square foot, in FY 1997 dollars, for our existing space; and GSA is quoting rates of \$30 per square foot for expansion space to house approved FY 1998-99 new hires. Per the prospectus, the maximum cost per rentable square foot for the consolidated space is \$25.41 (in FY 1997 dollars).

Recommendation Two: The PTO should prepare a detailed space requirements analysis for PTO's future needs. To take advantage of the opportunity to forgo the construction of unneeded space, this space use plan should be completed before lease award such that PTO can use the plan in its negotiations with the offerors. In preparing its space requirements, PTO should consider forgoing the construction of at least 100,000 square feet of office space.

We agree that a detailed space requirements analysis for PTO's future needs is necessary, and we completed the square footage requirements analysis on October 1, 1997, for use in partnership discussions with PTO's unions (see Attachment B, "Space Allocation Plan - Partnership," hereinafter referred to as the Space Allocation Plan). On November 17, 1997, two of the three PTO unions, NTEU Chapter 245 (representing Trademark Examining Attorneys) and NTEU Chapter 243 (representing support and administrative personnel) agreed to the space allocation strategy set forth in the Space Allocation Plan and executed a Partnership Agreement to that effect (see Attachment C). The Patent Office Professional Association (POPA), representing patent examiners and certain technical personnel, declined to continue partnership on the Space Allocation Plan and we are now in negotiations with POPA.

Space build-out requirements analyses (e.g., allocation of lighting between ceiling and task lighting; specifications for special areas such as computer facility, etc.) that will be needed to develop design documents after lease award, are now under way and on schedule. In this regard, it is important to note that in 1992, GSA paid over \$1 million for Leo A. Daly, an architectural-engineering (A/E) firm, to develop a six volume Space Requirements Report, including a detailed cost analysis, that served as the basis for the prospectus and initial SFO development. The PTO shared this, and the revalidation of its overall conclusions that was prepared in 1995 by Heery International (another A/E firm), with your staff. Further, in 1995, the PTO conducted facilitated sessions with representatives of all three PTO unions, management, the patent and trademark bars, independent inventors and public searchers in order to identify their respective priorities for the facility. All of the foregoing information was used by GSA/PTO to develop the many detailed performance requirements contained in the SFO that are specifically geared to ensuring that the successful offeror's base building systems are sufficient to support tenant construction (for one example, see SFO section G.11.2., "Electrical Distribution").

We do not agree, however, that the PTO should forgo the acquisition of any of the 1,989,116 occupiable square feet that was authorized in the prospectus. The Space Allocation Plan demonstrates that, even when reengineering efforts (specifically, paper reduction and work-at-home) are taken into account, the PTO will need the full facility to accommodate PTO operations in FY 2001-03, the period for phased occupancy of the facility.

Recommendation Three: The PTO should reach an agreement with the POPA membership union employees on work space and its configuration to facilitate the completion of its space plans in advance of the lease development award so that the bureau is able to specify the POR build-out requirements to the developer before the start of work.

We agree. The PTO is doing everything it can to reach an agreement with POPA. However, the process must follow labor management guidelines. In this regard, in accordance with Executive

Order 12871, from April 22 through August 28, 1997, management engaged in partnership discussions with representatives of the three PTO unions in hopes of reaching a partnership agreement on a POR. This initial effort did not generate an agreement. On September 3, 1997, NTEU 245 requested that management extend partnership discussions and on November 17, 1997, these extended discussions generated a partnership agreement with NTEU chapters 245 and 243. Unfortunately, on October 6, 1997, POPA declined to continue to participate in the partnership process; and, therefore, on October 10, 1997, in accordance with past practices, management served POPA with notice of management's intent to negotiate a Space Allocation Plan for the consolidated facility. Clarification meetings began on October 29, 1997, and continued to early January 1998, at which point the parties began negotiations. We are confident that the negotiation schedule (see Attachment D) allows sufficient time to reach either a negotiated or, if necessary, third-party imposed, decision on the issues.

Recommendation Four: The PTO should assess the impact of PTO's reengineering initiatives on the size of the new leased facility and factor those estimates into the bureau's space requirements plan. These estimates should reduce staffing requirements and the need for physical storage space for hard-copy patent records.

We agree that we should assess the impact of reengineering and have done so. Based on our calculations of workload and staffing growth, which have been approved by both the Department of Commerce (Department) and the Office of Management and Budget (OMB) in the FY 1999 budget process, we recognize that we must implement a number of significant reengineering changes in order to accommodate our FY 2001-03 program (the period when we will relocate to the consolidated facility) in 2 million square feet.

In this regard, we are focusing our attention on the area where we have made the most technological progress to date -- electronic search tools -- and have developed a space plan (see Attachment B) that is based on the assumption that we will take no paper patent search files to the consolidated facility. In support of this plan, on October 10, 1997, management served notice to POPA of management's intent to eliminate all paper search files for patent examination as soon as appropriate in select technologies, with the ultimate goal of removing all paper search files by late 2001. The parties are currently involved in negotiating management's proposal. Similarly, the space plan contemplates that we would not move the patent and trademark classified search files that are housed in the public search facility. Although this action will require a legislative change, we believe there is sufficient time between now and the move to obtain one. However, success in this regard will require the support of our user community.

We do not agree with your observations that it is appropriate to factor into space plans for 2001-03 occupancy either (i) the impacts that the Patent Application Management System (PAM) will have on requirements for space to house paper or personnel or (ii) the impacts that work-at-home will have on requirements for space to house personnel.

The policy and technological issues that must be resolved (e.g., security of electronically filed/transmitted proprietary data; customer agreement on application standardization and electronic amendment processing; transmission of enormous amounts of search data to examiners' homes over a wide area network) before patent personnel and paper reduction gains can be realized from our patent examiners working at home or from PAM implementation are too numerous and their resolution is too speculative for the PTO to risk building a facility that is too small to house our 2001-03 operations. We fully expect to realize long-range space and staff savings as a result of work-at-home and PAM, which should significantly impact our requirements for future expansion space after we consolidate.

Although the FY 1999 budget states that up to 80 trademark attorneys may be involved in work-at-home, using your analysis (on page 20 of the Draft Report), this would only reduce our space needs by about 40 offices, or approximately 6900 occupiable square feet (based on 120 square foot offices, plus circulation). Dramatic space savings from work-at-home can only be achieved when patent examiners are able to work at home, which is not likely to happen until several years after we consolidate (i.e., only after full implementation of PAM and solution of the technological problem of transmitting massive data files, many of which will be proprietary, to computers situated in examiners' homes).

Electronic patent applications (for PAM) will begin to be implemented in 2001 but will not be fully deployed until 2003, in accord with our agreement with Vice President Gore on the Year 2000 goals. Even when PAM is fully implemented, it will take several years to fully eliminate all paper application files, since we will not convert application files already in process when we shift to automated filing. While we will definitely achieve personnel savings from PAM implementation, particularly in the pre-examination and post-examination areas, the actual art of examining, i.e., the intellectual process, can never be automated. Assuming continued increases in filings and increasingly more complex filings, one can reasonably expect that the complement of patent examiners will rise, most likely offsetting any benefits from downsizing our manual processes.

In this regard, the Space Allocation Plan adopts the innovative space planning approach of a "universal grid," which many private corporations engaged in reengineering are now utilizing. Space will no longer be assigned based upon rank; rather, it will be assigned functionally, within the parameters of the grid. Therefore, all private offices would be the same size (120 sq. ft.) and open space support workstations would be either 60 or 80 sq. ft., so that, as automation progresses, support spaces can be easily converted to professional work spaces. This grid approach will eliminate the millions of dollars of annual "churn" costs that are generated by reorganizations and the current need to reconfigure space to accommodate multiple space standards. It will permit us to continue to make future reengineering improvements, unconstrained by space limitations.

The 120 sq. ft. grid was developed functionally, based upon an independent professional space planning study of the various job types in the agency. The study also concludes that, due to the cognitive nature of many PTO jobs, the agency's build-out should contain a high proportion of private offices, with numerous dispersed "team rooms" to accommodate group interaction. This

“teaming” concept is also consistent with the “Business Communication Case for Change” report and recommendations which resulted from a joint labor-management working group. The study also finds that many of our support personnel are currently operating in grossly inadequate work areas, and that the nature of their work and compliance with the Americans with Disabilities Act necessitate expansion of their work areas (to 60 or 80 sq. ft., as functionally appropriate). We achieved a partnership agreement with the National Treasury Employees Union (NTEU), Chapter 243, which will make needed changes a reality.

Patent applications are expected to grow at 5% per year and Trademark applications are expected to grow at 10% per year through 2003. At a sustained 5% growth level, the number of patent applications would nearly double in fourteen years. At a sustained 10% growth level, the number of trademark applications would nearly double in seven years. Even with reengineering efficiencies, over a 20-year term with these increases in workload, it is very unlikely a facility at a fixed level of space would need to shrink in size.

In summary, design elements incorporating reengineering considerations, efficiencies from reduced dependency on paper files and process efficiencies will allow us to stay at the total square feet available in the approved prospectus. We would have required a larger amount of space without these savings.

Recommendation Five: The PTO should prepare a discrete build-out budget before lease development award in [October] 1998 that PTO can incorporate into its negotiations with the developers. PTO must estimate a final cost of the build-out and specify this limit in the SFO as an absolute limit of the government's liability for the build-out. Fees should be based on the up-front proposed, not actual costs. [Note that GSA has informed us that, due primarily to offeror-initiated actions, lease award is now scheduled for October, not July 1998.]

We agree that a detailed budget is required, and have one. At GSA's request, Heery International prepared a detailed, 1200 plus page cost analysis which sets forth the basis for the \$88 million fit-out allowance and the \$29 million estimate for PTO above-standard alterations. The analysis, dated September 29, 1995, was reviewed by your staff in the course of the audit.

GSA has, on numerous occasions, assured us that the \$88 million is sufficient to deliver a fully built-out and tenantable facility, including special purpose spaces such as the central computer facility and day care facility, in accordance with Federal Property Management Regulation (FPMR) standards. As you know, FPMR-standard space excludes many building features, inappropriately-termed, we believe, “above-standard items,” which Federal agencies consider essential to efficient operations. These items -- such as an uninterruptable power system to protect our computer facility; locks on private office doors (in our case, to protect proprietary data); a 2' by 2' ceiling to improve lighting distribution -- will be covered by the \$29 million estimate for non FPMR-standard items. Other items projected for construction as non FPMR-standard items are space improvements such as clerestories for private offices (to bring light to interior spaces), upgraded carpet in high traffic areas and bumper guards in halls to protect them from cart damage.

We also agree that there should be an absolute limit on Government liability for build-out, but disagree that the SFO as drafted does not set such a limit. In this regard, we direct your attention to SFO paragraph G.1.2., which states that the Lessor must provide, within the rental consideration, base building construction and an \$88 million fit-out allowance and that:

“The Lessor’s “Base Building” construction and the Lessor’s Fit-Out Allowance are expected to deliver a Facility that is ready for Government occupancy, fully capable of supporting all anticipated Government functions.”

It would be inappropriate to include any reference to the \$29 million for non FPMR-standard items in the SFO/lease, because the Government cannot guarantee that such funds will be made available or expended; nor do we want to create a contractual obligation to commit these funds to build-out of the facility. The budget process, which includes Department, OMB and Congressional review, is the appropriate forum for review and approval of planned PTO expenditures for non FPMR-standard items. In that regard, in the FY 1997 reapportionment process, the Department and OMB initially rejected PTO’s proposal to transfer a \$5 million reimbursable work authorization to GSA as a partial deposit on the \$29 million estimate. It was only after detailed review of the planned improvements and numerous meetings on the project structure that the Department and OMB agreed that the transfer should be made. In the FY 1999 Budget process, OMB approved inclusion in the President’s Budget of an additional \$15 million transfer to GSA, but only after extensive review by the OMB examiner.

The SFO contains other provisions that are designed to address the fit-out ceiling. Section D, which covers “Post Award Development Requirements,” contains several provisions that are directed at ensuring that the Lessor both controls costs and does not exceed the \$88 million ceiling. For example, paragraph D.6.10 requires the Lessor to competitively bid all fit-out work; and paragraph D.6.8. requires the Lessor to allocate the fit-out allowance among construction stages and to prepare three (3) detailed cost estimates for each stage (with Lessor submission of space plans, design intent drawings, and construction drawings). In particular, paragraph D.6.8. requires the Lessor to notify the Government when it appears that actual costs will exceed estimates and further requires the Lessor to recommend alternatives to stay within the mutually-agreed budget; specifically:

“Each Cost Estimate shall demonstrate the design conformance for that Stage to the pro-rated amount of Fit-Out Allowance to be utilized for such Stage, as said allocated amount is set forth in the Budget. The Lessor shall submit a cost control report with each Cost Estimate if construction cost estimates exceed the allocable portion of the Fit-Out Allowance, as set forth in the Budget. This cost control report shall identify the components of the Cost Estimate which caused the excess cost, shall provide a reconciliation of the current Cost Estimate with the most recent previous estimate, and shall identify means, materials, assemblies or components that could be designed or specified differently that would bring the estimated construction costs within the Budget.”

This language was drafted to ensure that there is an ongoing process of review and reconciliation of project costs throughout the phased construction of the facility. As we have to date, the PTO and GSA will work closely together throughout the construction administration phase to ensure that every step of the process is carefully monitored.

Recommendation Six: The PTO should not appoint a PTO representative to serve as the contracting officer's representative (COR). PTO should not allow a PTO COR to have the authority to direct the contractor's work independent of the GSA contracting officer.

We disagree, and believe that this recommendation is based upon a mis-reading of the SFO by the IG. SFO paragraph D.8.7., as its title, "Post Acceptance Alterations" indicates, does not give a PTO COR authority to make changes to or accept the initial construction of the facility. Rather, it is a standard provision, included in most GSA leases, which permits an agency to order alterations to the space during the term of the lease, i.e., after construction is completed and after the facility is occupied. Actual orders for alterations after construction and during occupancy would be placed by the COR acting pursuant to a delegation from GSA. We have a delegation to operate and administer the leases for many of our existing buildings, and contemplate having one for the consolidated facility. Per the language of paragraphs D.8.7.a-d., the GSA Contracting Officer will negotiate unit prices which shall serve as the basis for such orders or, in certain instances (paragraph D.8.7.e.), the Lessor will be requested to provide a price proposal. The PTO ensures that individuals performing the duty of a COR are properly trained, and both GSA and the Department regularly audit our execution of the delegation program, which further ensures that the COR exercises his/her authority properly.

Recommendation Seven: The PTO should specify that the developer/lessor must accumulate costs at the lowest individual task level before lease development award, in order to control and monitor costs during the build-out phase.

We agree that fit-out costs should be identified to a level sufficient to ensure that no base building scope is allocated to the \$88 million fit-out allowance and to ensure that prices have been competitively established; however, we do not agree that this should be done before lease award. The appropriate time for such cost identification is when the Lessor presents his cost estimates for each construction stage (see discussion under Recommendation Five, above). SFO paragraph D.6.8. requires that the Lessor's estimates be in 16-division Construction Specification Institute (CSI) format; and SFO paragraph D.6.10., "Final Pricing/Bidding," establishes further cost control mechanisms. However, we have spoken to GSA about your concerns and they have agreed to review the SFO language in order to determine whether additional cost control mechanisms are in order, and to issue an SFO amendment, if necessary. We will involve the Department's real estate management staff in these discussions.

During the course of the audit, both GSA and the PTO discussed the three possible build-out approaches that might be used (fit-out allowance, unit costs/unit prices or specifications and pricing prior to lease award) and our reasons for selecting the fit-out approach for this project. All three methods, as do all business decisions, carry risk. We identified the fit-out approach as the method that subjects the Government to the least risk, given the considerable time lapse

between lease award and occupancy of the PTO facility. In making this decision, we employed the services of a private real estate expert, two internationally known A/E firms, and numerous Government attorneys. All agreed that the approach which the Draft Report appears to suggest we adopt - specifications and pricing prior to lease award - would subject the Government to the highest degree of risk. This observation has been borne out by discussions with the Internal Revenue Service, which has had to pay hundreds of thousands of dollars in change orders on the design build New Carrollton project.

Recommendation Eight: The PTO should execute a written interagency agreement with GSA to record the terms and conditions of the agencies' oral understandings. The agreement should specify the rights and responsibilities of each agency, allocate project risk, set levels and payment terms of fees, specify conditions for turning back unneeded space to GSA, and define GSA's role in the continuing development and operation of the lease, especially in light of PTO's potential reorganization as a performance-based organization. The agreement should also be cleared through the Office of General Counsel (OGC).

We agree, and a draft Memorandum of Understanding (MOU) prepared by the PTO was sent to GSA on September 29, 1997. We are awaiting a response from GSA and will clear any agreement with both the Department's real estate management staff and OGC.

Recommendation Nine: PTO should not agree to any fee arrangement with GSA that would represent a prohibited cost-plus-percentage-of-cost fee or a fee in excess of statutory limits.

We agree, and have no intention of agreeing to pay GSA any fee that would be prohibited were we to execute a contract for the same services with a private A/E firm. We do not, however, believe that these statutes apply to interagency agreements. We do concur that such fees are improper and excessive and at no time have we had any discussions with the GSA project team which should lead GSA to believe that we would contemplate paying them. We will ensure that the MOU with GSA is clear in this regard.

Recommendation Ten: The Department should provide oversight, assistance, and guidance to ensure that PTO completes its union discussions and POR space requirements in time to avoid delaying lease award. In addition, the Department's real estate management staff and procurement oversight staff should review the terms of the SFO, lease award, and interagency agreement with GSA to ensure that the project incorporates terms and conditions that are acceptable to the Department.

We agree, and welcome the Department's oversight of and participation in this massive project. However, we believe that the Draft Report creates the mistaken impression that such oversight has not been exercised thus far. For example, we coordinate with OGC on an ongoing basis regarding the legal implications of proposed strategies with our unions. This coordination ensures that the positions we advance are legally sufficient and that arguments can effectively be made by that office to a third party, should negotiations not achieve the desired result. The Department's real estate management staff commented extensively on the SFO before it was issued, and those comments were incorporated into the final product. Also, we discussed and

cleared the draft MOU with the Department's real estate staff before we transmitted it to GSA. We have had numerous meetings with the staff and Departmental senior management to discuss the strategy for/parameters of the procurement and are, we believe, in agreement that we are proceeding properly.

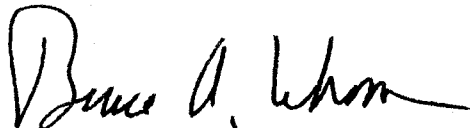
In this regard, we recently added a Departmental senior executive as a voting member of the Source Selection Advisory Board (in addition to the one now serving in an advisory capacity), so that the Office of the Secretary will have a direct voice in the selection process.

We recognize that it is important, particularly given the economic and political ramifications of the project, that we seek Departmental buy-in and approval of all key decisions and expenditures; and we shall continue to do so.

Lastly, the Department will continue to exercise, through the budget formulation and execution processes, oversight of all expenditures relative to the future lease acquisition.

Recommendation Eleven: The Department should establish effective oversight policies and procedures for future lease development and construction procurement actions conducted by PTO or other Commerce bureaus, regardless of whether these are under independent leasing authority or under the auspices of GSA. These policies and procedures should ensure that the Department reviews and approves the project at its earliest stages through to completion.

We agree, and the Department recently published an amendment to the "Real Property Management Manual" which addresses this concern and contains a stand alone chapter on the approval process for major real estate projects. Although this chapter was published subsequent to prospectus authorization and issuance of the SFO for the PTO project, procurement reviews have been conducted since project inception and are ongoing.



Bruce A. Lehman

Attachments

cc: Scott Gould, Assistant Secretary for Administration



UNITED STATES DEPARTMENT OF COMMERCE
Chief Financial Officer
Assistant Secretary for Administration
Washington, D.C. 20230

JAN 16 1998

MEMORANDUM TO: Johnnie E. Frazier
Acting Inspector General

FROM: W. Scott Gould *WJG*

SUBJECT: O/S Response to the Office of Inspector General
Draft Inspection Report, Patent and Trademark
Office: *Insufficient Planning Is Jeopardizing*
PTO's Space Consolidation Project
(Report No. IPE-9724)

This is the Department's response to the subject Office of Inspector General's (OIG) Report. Since receiving the draft Report, my staff has carefully reviewed each of the recommendations, and we are providing our response to each of the recommendations below.

OIG RECOMMENDATIONS

1. PTO should continue with lease development.

O/S Response: *We agree. With all of PTO's current leases expiring in the 2000-2002 time frame, this is a unique opportunity to pursue a consolidation procurement which will be at the minimum cost to the Government. Delaying the procurement would cost the Government millions of dollars in both non-competitive lease extensions and in potential protests from the participating bidders.*

2.a. PTO should prepare a detailed space requirements analysis for PTO's future needs.

O/S Response: *We agree. With the agreements between the National Treasury Employees Union's (NTEU's) chapters 243 and 245, PTO has reached agreement with 1,993 out of 4,244 PTO union employees. Coupling this with the 2,214 non-union employees, PTO should be able to prepare space requirements for 4,207 out of 7,108 (59.2%) total employees going to the lease consolidation. We agree that planning should proceed for these employees as well as for the space not tied to union contracts such as fitness facilities, day care, conference rooms, etc. We strongly encourage PTO to reach an agreement with the Patent Organization Professional Association (POPA) as soon as possible so PTO can then begin with space requirements for the final 1,993 employees.*

2.b. This plan should be completed before lease award such that PTO can use the plan in its negotiations with the offerors.

O/S Response: We agree that the plan should be completed before lease award - this is a requirement of the lease. Also, in order to exercise the option of giving back up to three blocks of 100,000 square feet, notification must be made to Lessor prior to lease award. However, we do not believe having the plan completed before lease award will enable PTO or GSA to use the plan in negotiations with the offerors, unless the procurement is substantially altered (See #5).

2.c. In preparing its space requirements, PTO should consider forgoing the construction of at least 100,000 square feet of office space.

O/S Response: We agree, provided this is the result of the space requirements analysis.

3. PTO should reach an agreement with the POPA membership union employees on work space and its configuration to facilitate the completion of its space plans in advance of the lease development award so that the bureau is able to specify the POR build-out requirements to the developer before the start of work.

O/S Response: We agree and will continue to encourage and monitor the progress of these negotiations.

4. PTO should assess the impact of PTO's reengineering initiatives on the size of the new leased facility and factors those estimates into the bureau's space requirements plan.

O/S Response: We believe they have done so. Per the draft report, page 17, PTO has assessed the impact of such reengineering initiatives, and believes any benefits from these will not be realized until after 2001. Based on PTO's recent history of scattered expansion all over Crystal City and the current long-awaited opportunity of a consolidation, we disagree with the logic that '...PTO should program employee and space savings into its space plan before the final dimensions and interior design of the new leased space facility are finalized' (page 19). We are cautious in seeing a facility that has not been designed large enough, so GSA/PTO has to begin expensive non-competitive expansions as has been done over the years in Crystal City. The most likely possibility of space savings through reengineering will be in the elimination of paper files through its new Automated Patent System (APS) and Patent Application Management (PAM) systems. This is the easiest space to give back to GSA since it will not have been built out to office standards and can be easily be configured for the next tenant.

5. PTO should prepare a discrete build-out budget before lease development award in July 1998 that PTO can incorporate into its negotiations with the developers. PTO must estimate a final cost of the build-out and specify this limit in the SFO as an absolute limit of the government's liability for the build-out. Fees should be based on the up-front proposed, not actual costs.

O/S Response: *As the draft report states, there are (at least) three methods of handling the costs associated with the buildout, each having strengths and weaknesses. GSA has chosen the method most commonly used in the private sector, where the tenant is given a standard buildout allowance as part of the rental consideration. We believe at this stage of the procurement, with so much to be gained by consolidating the PTO, that changing the fundamental structure, thus in all probability having to start the procurement over from scratch, is not worth whatever savings could be achieved, which are not known or stated in the draft report.*

6. PTO should not appoint a PTO representative to serve as the contracting officer's representative (COR).

O/S Response: *We disagree. The reference to the COR (SFO Section D.8.7) comes under 'Post Acceptance Alterations'. These are alterations that may be performed throughout the twenty-year term of the lease following the completion of the initial buildout. Many large GSA-leased, solely DOC-occupied buildings are delegated to DOC to manage throughout the term of the lease (NOAA in Silver Spring, some of PTO's buildings in Crystal City). They all have non-GSA CORs who handle alterations projects from time to time following the initial buildout. This is not an unusual practice, nor has there ever been a problem with this practice. This COR program allows tenants in large buildings, in which they are the primary tenant (occupying at least 90 percent of the building), to deal directly with the landlord on minor alterations projects without having to involve GSA. During the initial buildout, there is no PTO COR; the GSA Contracting Officer is the sole holder of the Government's authority.*

7. PTO should specify that the developer/lessor must accumulate costs at the lowest individual task level before development award, in order to control and monitor costs during the build-out phase.

O/S Response: *We agree and will discuss with PTO and GSA as to how this provision can be worked into the final lease agreement, most likely in Paragraph D.6.8 - Cost Estimates.*

8. PTO should execute a written interagency agreement with GSA to record the terms and conditions of the agencies' oral understandings.....The agreement should also be cleared through the Office of General Counsel.

O/S Response: *We agree and will continue to encourage and monitor the progress of this agreement.*

9. PTO should not agree to any fee arrangement with GSA that would represent a prohibited cost-plus percentage-of-cost fee or a fee in excess of statutory limits.

O/S Response: *We agree; the new GSA rent policy, currently under review at OMB, is essentially a cost-plus percentage-of-cost fee. It is too early to tell the amount OMB will approve; we believe the fee will not be in excess of statutory limits or in conflict with any Federal regulations.*

10.a. - The CFO/ASA should provide oversight, assistance, and guidance to ensure that PTO completes its union discussions and POR space requirements in time to avoid delaying lease award.

O/S Response: *We agree and will continue to provide oversight, assistance and guidance.*

10.b. - The Department's real estate management staff and procurement oversight staff should review the terms of the SFO, lease award, and interagency agreement with GSA to ensure the project incorporates terms and conditions that are acceptable to the Department.

O/S Response: *We agree, have done so, and will continue to do so. The SFO was thoroughly reviewed by this office and comments were forwarded to GSA/PTO and were incorporated into the final SFO (we also forwarded a copy of the initial SFO to the OIG). The Department has placed Robert Welch, Director, Office of Acquisition Management, on the Source Selection board as a voting member. Eugene Smith, Office of Real Property Policy and Major Programs, meets with key GSA and PTO staff regularly to discuss this procurement.*

11. - The CFO/ASA should establish effective oversight policies and procedures for future lease development and construction procurement actions conducted by PTO or other Commerce bureaus, regardless of whether these are under independent leasing authority or under the auspices of GSA. These policies and procedure should ensure that the Department reviews and approves the project at its earliest stages through to completion.

O/S Response: We agree and will continue to do so. We have recently created Chapter 10 of the Real Property Management Manual, which describes in detail the policy of the Department regarding any prospectus-level repair, alteration, construction or lease project for DOC. All of these projects, whether being performed by GSA, a bureau, or anyone else, must be submitted for a preliminary review and final authorization/approval by the CFO/ASA prior to project commencement.

My staff will continue to work with your staff to ensure that there was no misunderstanding of our interpretation of the intent of your recommendations and that our responses are sufficiently detailed. We will also keep your staff informed on the progress we are making in implementing the recommendations.



U.S. GENERAL SERVICES ADMINISTRATION
National Capital Region

JAN 30 1998

Mr. Johnnie E. Frazier
Asst. Inspector General for Inspections
and Program Evaluations
United States Department of Commerce
14th St. & Constitution Ave.
Washington, DC 20230

RE: Comments on Draft Inspection Report
Patent and Trademark Office (PTO) IPE-9724

Dear Mr. Frazier:

The National Capital Region (NCR) of the General Services Administration (GSA) has reviewed a copy of the above draft report. We are pleased to see that the Department of Commerce (DOC) continues to be interested in and committed to the successful completion of this important project. GSA also believes that the consolidation will result in benefits to the government, the employees of the PTO and the public, in particular those whose fees fund the operation of the PTO. We applaud your effort, and we feel that the report is well targeted, thorough, and unbiased in presentation. We generally agree with the report, and we offer the following general observations. Specific corrections and comments are attached.

Section III of the report addresses the proposed strategy for tenant fit-out, and suggests that the provision of a build-out allowance exposes the government to cost and schedule risk. The report seems to suggest, although it does not definitively state, that either a bid from detailed drawings or a priced list of build-out items would be preferable. In fact, the Solicitation for Offers (SFO) utilizes the best aspects of all three approaches to minimize both cost and schedule risk. Prior to lease award, when the exact nature and quantity of the build-out is the least defined and the most subject to future cost uncertainty, the SFO specifies a build-out allowance. GSA is confident that this allowance, which was generated from a 1200 page cost estimate, will be sufficient to deliver a build-out of the facility consistent with the Federal Property Management Regulations (FPMR).

After the design drawings are complete, the Lessor is required to competitively bid the build-out, and to provide a set of competitively bid unit prices. We would suggest that the project may be characterized as a competitively bid construction project nested within a negotiated source selection lease. GSA remains firmly convinced that it is inappropriate to specifically design and price special items or particular shapes and sizes of rooms prior to identification of the particular building and years before the actual construction.

7th and D Streets, SW, Washington, DC 20407



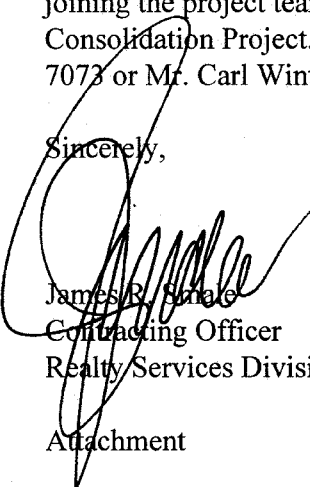
As to the lack of an interagency agreement, or Memorandum of Understanding (MOU), between GSA and PTO noted in Section IV, we agree that such an agreement should be finalized as soon as possible. We regret any confusion that our changing pricing and service delivery policies may have caused. Please be assured that the agreement between GSA and PTO will address many of the issues you raised in the report.

Under GSA's new pricing policy, we will be proposing a single fixed fee to cover all the services which we will deliver. For this fixed fee, GSA will perform real estate brokerage and management services which will include lease acquisition, administration, security and indemnification. GSA's incentive to control cost is based upon our commitment to delivering an FPMR level of build-out within the \$88 million allowance, while doing the best job possible for PTO and the taxpayer.

Regarding your reference to a PTO Contracting Officer's Representative (COR), we believe you are reading language in the SFO which addresses post-acceptance alterations. GSA will retain responsibility for administration of the tenant fit-out allowance and for authorizing any changes to the initial space alterations. After the initial space alterations are complete, PTO may receive authorization to perform changes throughout the remainder of the Lease term, as is customary in a delegated facility.

As always, we welcome your comments regarding the procurement. We thank you for joining the project team who is committed to ensuring the excellence of the PTO Consolidation Project. If there are any further questions, please call me on (202) 401-7073 or Mr. Carl Winters at (202) 401-1025.

Sincerely,



James R. Senale
Contracting Officer
Realty Services Division

Attachment



ATTACHMENT A
SPECIFIC COMMENTS REGARDING
THE DEPARTMENT OF COMMERCE OFFICE OF INSPECTOR GENERAL
DRAFT INSPECTION REPORT – IPE-9724

1. General. Since your draft was authored in August 1997, the scheduled lease award date of July 1998 has been changed to October 1998. Therefore, a search-and-replace for the July 1998 date, as well as the corresponding “seven” months remaining before lease award, should be done on the document to correct this date. The project schedule has extended due to a change in the Phase II evaluation criteria to consider preliminary results of the environmental impact study and due to requests for extensions by offerors at different milestones of the submittal process.
2. General. Throughout the document, references are made to “space planning” (page 6), “detailed space plan” (page 9), “interior design” (page 10) and refinement of “interior build plans” (page 24) prior to Lease award. This may be due to imprecise language, since “space plan” is a term of art within the design community, or it may represent a misunderstanding of the proposed process. There will not be, nor should there be, any interior design or space planning prior to identification of the successful offer. Space plans, by definition, are specific drawings which describe the layout within a particular building. They will be produced by the Lessor, based on the PTO’s Program of Requirements (POR). The POR is a listing of all the personnel and/or functions which require space and a description of the space required by each. The POR is required before Lease award, but space plans are not.
3. Executive Summary, page iv. *Therefore, this process is flawed because the lease development project lacks a defined cost ceiling.*
See comment at No. 14 below.
4. Executive Summary, page v. *The fee structure for GSA’s effort is undefined.*
See comment at No. 18, 19, 20 below.
5. Executive Summary, page vi. *...largest federal construction projects...*
This is not a federal construction project. The consolidation project is a federal lease project.
6. Background, page 3, footnote #6. *PTO pays GSA approximately \$31 per square foot after adding agency fees and other costs.*
The comparison between rental rates is misleading. GSA’s payments to the lessor are calculated in rentable square feet. PTO’s payments to GSA are calculated in assigned occupiable square feet. GSA leases approximately 1.9 million rentable square feet of office space for PTO in Crystal City, which yields only 1.5 million assigned occupiable square feet. PTO’s cost of approximately \$30 per assigned occupiable square foot is not directly comparable to the prospectus rent, which is quoted in rentable square feet.

7. Background, page 3, footnote #7. *GSA determined that the \$24 per square foot...*
The Office of Management and Budget (OMB) forced this rate into the prospectus and GSA demurred to advance the prospectus.
8. Background, page 5. *Rent will be paid on the total "gross area" of occupiable and general use space.*
This statement is confusing. "Gross area" and "occupiable space" have entirely different meanings, and their combination in this sentence is difficult to understand. In fact, the rent will be paid on rentable square footage.
9. Background, page 7. *...consideration of existing fit-out costs, unduly prejudiced...*
The word "costs" should be replaced by the word "value". It was the value of their existing fit-out for which they sought credit.
10. Text, Page 21. *The total cost of this error for the eight months in question is approximately \$1.5 million because PTO is paying an average of \$30 per square foot in rent to GSA annually.*
The calculation is not correct because the average rent is \$22/rentable square foot, not \$30. Also, PTO is not currently paying GSA for all of this space, since the initial alterations and acceptance are not complete. Past practices, however, suggest that the space will be billed in arrears once it is occupied and assigned.
11. Text, page 24. *...and no negotiations over the build-out are contemplated.*
This statement is not accurate. While it is true that the Lessor will be sole source contract conduit for the fit-out, the general contractor or individual construction contracts/subcontracts will either be competed to GSA satisfaction or shall be subject to price negotiation with GSA. These actions are explicitly detailed in the Solicitation for Offers (SFO).
12. Text, page 26. *This arrangement makes the office space more marketable in terms of cost and therefore more attractive for a new tenant.*
This statement as a summary for your argument is true only if a new tenant would take the space "as-is". Accepting "as-is" space without any initial space alterations is a rarity for GSA clients in the NCR.
13. Text, page 26. *This cost estimate should then be incorporated into the SFO as a contractually binding ceiling for the build out.*
Since PTO has no privity to the lease contract, this would only contractually bind GSA and the Lessor. Also your arguments suggesting limits or "ceilings" are not purely logical, because the prospectus authority defines the ultimate money limit for the space provided at the levels defined by the FPMR. Any "ceilings" are only binding to the extent that what is ultimately constructed is exactly what was priced. The real ceiling on the cost of the project is the prospectus rent, which includes an FPMR level of build-out.

14. Text, page 27. *Nonetheless, because of a lack of detailed build-out requirements in the SFO, the government will not be able to get at least a competitively bid baseline on the initial build-out design, before any changes are made. and With a normal build-out allowance containing a contract ceiling, there is no incentive for the developer to buy in on the build-out.*

With these statements the report counters the GSA and PTO claims to the contrary listed in the same discussion, but the logic is faulty. Hypothetically for any contract with a guaranteed maximum, if an offeror is not permitted to establish the maximum in his proposal, competition will not achieve the lowest cost or the lowest guaranteed maximum (*competitively bid baseline* from your statement). If the government sets this value in the SFO as you propose, each bidder will approach the maximum by vying with the other bidders only to see who can be closest to the maximum and still be low. There will be no incentive to “buy in”. Avarice dictates that leaving easy money on the table is less risky than the strategy of low-balling the bid to perhaps make it up later via high cost changes.

15. Text, page 27. *By tracking the contractors cost data to the lowest level of change activity, PTO will be better able to control build-out costs and monitor the developer’s performance.*

The meaning of “lowest level” is not clear. Please remember that the privity of the GSA contract does not extend beyond (lower than?) the Lessor. GSA will obtain fit-out information from the Lessor at the level of detail necessary to ensure that the scope of work is correct and that the prices are fair and reasonable.

16. Text, page 29. *...that PTO could better shoulder some of that risk, although at an increased cost to the government.*

The phrase after the comma is conjecture. Removing the energy (not utility) costs from the lease is intended to decrease the total cost to the Government, since it does not require that the Lessor add his fee plus a mark-up for future uncertainty in utility rates and quantity of usage.

17. Text, page 29. *Some GSA representatives believe that this will result in inefficient, boxy, and unsatisfying architectural structures.*

While this statement imparts the vulgar truth, it would more politic to say, “may result in speculative type office buildings”. It should also be noted that the efficiency and architectural merit of each proposal is heavily weighted under the evaluation criteria specified in the SFO. It is virtually impossible to draft a specification to entirely eliminate “boxy and unsatisfying” architecture, particularly in a lease project which also includes a consideration of site, operations and maintenance and price.

18. Text, page 33. *...based on actual costs expended, with a fee rate from 3 percent to 9 having been discussed.*

The 3% to 9% fee range quoted in the report is only applicable to Reimbursable Work Authorizations (RWA’s), which are typically for discrete, individually priced and administered items of work, added to an existing contract. This fee range is not

applicable to the overall PTO project.

19. Text, page 34. *By statute, fees for architect-engineering contracts, to include construction management "shall not exceed 6 percent of the estimated cost of construction."*
The reference to a 6% limit on architecture and engineering fees is drawn from the Brooks Act which we understand only applies to a contract between the Government and an architectural/engineering firm. Government agencies have historically charged fees to cover their overhead to other agencies as well as divisions of their own agencies. Also, the services provided by GSA will include more than construction management; they may include lease administration, security and indemnification against vacancy risk. At any rate, the total fee for this project will be less than 6%.
20. Text, page 34. *...the fee represents a cost-plus-percentage-of-cost (CPPC) contract, which is expressly prohibited by statute in the contractual contest.*
This argument was achieved by extrapolation logic. Strictly speaking, there can be no contracts between government agencies.
21. Text, page 34. *Specifically, GSA would have no incentive to monitor costs or rein in over-designing or over building by PTO.*
Technically, you are correct. GSA is now a customer service oriented agency. We are no longer charged with policing an agency's statement of needs. If an agency has the funds, we will build what they wish, as long as no laws are broken and it does not render the space unusable for a future tenant. However, as is the case with any consultant whose revenues are based on customer fees, our incentive for monitoring the construction lies with the fact that we must serve the interests of our client well to stay in business.
22. Text, Page 37. *For example, the SFO does not have a cost ceiling for the build-out of the building shell.*
The prospectus limitation is the cost ceiling for the building shell, plus the \$88 million FPMR quality fit-out allowance, plus the energy costs.
23. Recommendations, Page 38. *PTO must estimate a final cost of the build-out and specify this limit in the SFO as an absolute limit of the government's liability for the build-out.*
See comment at No.14 above.
24. Recommendations, Page 38. *Specifies that the developer/lessor must accumulate costs at the lowest individual task level before lease development award, ...*
See comment at No.15 above.