Comptroller General
of the United States

Washington, D.C. 20548

Decision

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Matter of: Hughes STX Corporation

File: B-278466

Date: February 2, 1998

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David S. Cohen, Esq., Cohen Mohr LLP, and Helaine G. Elderkin, Esq., for Computer Sciences Corporation, an intervenor.
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Linda S. Lebowitz, Esq., and Michael R. Golden, Esq., Office of the General Counsel, GAO, participated in the preparation of the decision.

DIGEST

Protest is sustained where the cost realism evaluation was unreasonable and discussions conducted with the protester concerning its proposed direct labor rates were not meaningful.

DECISION

Hughes STX Corporation protests the award of a contract to Computer Sciences Corporation (CSC) under request for proposals (RFP) No. DTRS57-97-R-00001, issued by the John A. Volpe National Transportation Systems Center, Department of Transportation, Cambridge, Massachusetts, for on-site information systems support. Hughes challenges the agency's evaluation of cost realism, conduct of discussions, and source selection decision.

We sustain the protest.

The RFP, issued on December 19, 1996, contemplated the award of a level-of-effort, cost-plus-fixed-fee contract for a 2-year base period and three 1-year option periods. For each year of the contract, the RFP required offerors to provide 287 direct labor years of information systems (IS) personnel and 13 direct labor years of contract administration (CA) personnel.[1] The RFP specified ten IS and nine CA labor categories and provided staffing levels for each category. Under the RFP, an

[1]Under the RFP, a single labor year equals 2,087 hours of direct labor.

offeror could propose to staff these labor categories with personnel employed by the offeror as the prime contractor or with personnel employed by the offeror's subcontractors.[2]

The RFP provided that the award would be made to the offeror whose proposal was determined to be most advantageous to the government, technical evaluation factors and an offeror's evaluated costs considered. The RFP contained the following five technical evaluation factors: (1) corporate experience and past performance; (2) performance plan for major functional areas of work; (3) professional employees compensation plan; (4) key personnel assignments; and (5) plan for contract management and contract operation. (Technical evaluation factors (1) through (3) were of equal weight, and the other two technical evaluation factors were of lesser weight and listed in descending order of importance.) With respect to technical evaluation factor (3), the RFP stated that an offeror's proposed professional employees compensation plan would be evaluated in terms of realism and its impact upon the recruitment and retention of quality staff in order for the offeror to furnish high-quality uninterrupted service. With respect to costs, the RFP stated that an offeror's proposed costs would be evaluated for fairness, reasonableness, realism, and consistency with an offeror's technical proposal. According to the chairperson of the cost business evaluation team (CBET), in evaluating an offeror's cost proposal for realism, the agency was concerned with the offeror's claim that it would retain a stated percentage of the incumbent staff in light of direct labor rates proposed. Hearing Transcript (Tr.) at 8.[3] In determining the most advantageous proposal, the RFP provided that an offeror's technical proposal would be the "most important factor" and the firm's cost proposal would be the "next most important."

Four firms, including Hughes and CSC, submitted initial technical and cost proposals by the closing date of February 12, 1997. Each of these proposals was included in the competitive range. In their respective proposals, Hughes proposed to retain approximately [deleted] percent of current incumbent personnel, and CSC proposed to retain approximately [deleted] percent of those personnel.

In evaluating offerors' proposed labor rates for realism, the agency was concerned with the offerors' ability to retain a [deleted] percentage of incumbent personnel in light of direct labor rates proposed. Tr. at 8. Accordingly, the agency decided to determine the realism of each offeror's proposed labor rates in terms of incumbent personnel retention by comparing the proposed rates to historical labor rates on an

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[2]The focus of this protest has been on the proposed direct labor rates of the prime contractors.

[3]The transcript citations in this decision refer to the transcript of the hearing conducted by our Office in connection with this protest.

individual labor category basis; the historical rates, which were essentially [deleted], were not disclosed to offerors. Tr. at 10, 17.[4] As stated by the chair of the CBET in the agency's post-hearing comments:

> [A]ll non-incumbents claimed [deleted] to [deleted] percent of the incumbent's staff would be retained. This meant that if the majority of the incumbent staff was to be retained by an offeror, the proposed labor rates could not be significantly below and must approximate [deleted] historical labor rates. . . . [C]omparison of offerors' proposed rates to [deleted] historical rates became the key to the labor evaluation.[5]

The agency assigned an individual cost analyst to each offeror's initial proposal. There were nine IS and eight CA labor categories for which historical salary information was available for the comparison of proposed and historical labor rates, and the analysts determined, on a labor category basis only, whether proposed labor rates were within [deleted] percent (above or below) historical labor rates. Tr. at 20. The analysts then calculated a total dollar figure representing the amount by which an offeror's total proposed labor rates were above or below total historical labor rates for all IS and CA labor categories.

Although not documented in the record (the agency admitted at the hearing, Tr. at 59, and in its post-hearing comments that this part of the evaluation was conducted informally in conversations and not written down), the agency states that it calculated an overall percentage by which an offeror's total proposed labor rates

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[4]The agency [deleted] the historical labor rates to [deleted] "in order . . . to get a realistic rate for the [deleted]," Tr. at 10, or in other words, to determine the amount the agency believed the contractor should be paying [deleted]. Tr. at 11. In this decision, all references to historical labor rates include [deleted] rates.

[5]During the hearing, the chair of the CBET stated his opinion as follows:

> [T]here [was not] a meaningful difference between [deleted] and [deleted] percent [proposed incumbent retention]. [He did not] have an arithmetic calculation that would show [him] what salary [he] would have to achieve to retain [deleted] versus [deleted]. As [he] viewed it, [deleted] or [deleted] percent [was] a preponderance of the staff. . . . [T]he nonincumbent[s'] claims that they would retain [deleted] to [deleted] percent suggested to [him] that a comparison to historical [deleted] information would be appropriate and should be similar. Now it need [not] be exact, but it needed to be similar.

Tr. at 8-9.

were below total historical labor rates. See Tr. at 58-62. The chair of the CBET stated that by comparing an offeror's total proposed labor rates in light of proposed incumbent retention rates to total historical labor rates, the realism of an offeror's proposal would be determined. Tr. at 17; see also Tr. at 19. The chair characterized this as looking at the "bigger picture." Tr. at 28.

More specifically, cost analyst A evaluated the initial cost proposal of Hughes. Analyst A noted that the firm (which, as noted above, was not advised of the [deleted] rates) proposed direct labor rates based on a number of extensive salary surveys of the Cambridge labor market. In noting that Hughes proposed to retain approximately [deleted] percent of the current incumbent employees, analyst A stated that "it appears [Hughes] ha[s] underpriced the rates of incumbent senior [higher priced] personnel." On a total basis, the Hughes proposed labor rates were approximately [deleted] percent below historical labor rates. Tr. at 25, 66-67. Analyst A concluded that "generally, [the Hughes] labor rates were lower than the . . . historical actual, particularly, in the [deleted]." See Tr. at 14-15. Analyst A also pointed out that Hughes did not escalate its labor rates for contract year one which "could result in a cost overrun of labor costs" if salary increases were given during year one, or if no increases were given, "could jeopardize [the] ability [of Hughes] to retain senior personnel."[6]

Cost analyst B evaluated CSC's initial cost proposal. Analyst B noted that the firm proposed to retain approximately [deleted] percent of the current incumbent employees. Comparing CSC's proposed labor rates to historical salary information, analyst B concluded that CSC's IS labor rates were "within [deleted] percent of available market," but that CSC's CA labor rates were "considerably wider" than available market rates, that is, CSC's CA labor rates were more than [deleted] percent below historical rates apparently for particular labor categories. Tr. at 18. On a total basis, CSC's proposed labor rates were approximately [deleted] percent below historical labor rates. Tr. at 25, 66-67. Analyst B also pointed out that CSC proposed escalation of direct labor rates for each contract year.

To summarize the above record, the following chart shows the average percentages by which the Hughes and CSC initially proposed labor rates for the IS and CA labor categories were below the agency's historical labor rates and the total overall Hughes and CSC average percentage deviations from the historical labor rates:

[6]In its initial proposal, Hughes stated it did not escalate labor rates for the first contract year because its salary data was indicative of rates to be incurred. Hughes did propose escalation for each of the other contract years.

	IS	CA	Total
Hughes	[deleted]%	[deleted]%	[deleted]%
CSC	[deleted]%	[deleted]%	[deleted]%

By letters dated April 18, the contracting officer conducted written discussions with each of the competitive range offerors by listing weaknesses and/or deficiencies in their respective technical and cost proposals. Concerning the cost proposal of Hughes, the contracting officer stated:

> A review of proposed first year labor rates by category indicates that they are lower, in many instances, than our historical data. Explain this disparity since Hughes has indicated that [deleted]% of the incumbent's employees will be retained. What would the impact be on employee retention?[7]

The contracting officer also asked Hughes to "[e]xplain why [its] survey labor rates . . . [were] not escalated to contract year one."

Concerning CSC's cost proposal, the contracting officer stated that "Contract Administration labor appears low compared to the Government's historical and market data. Does CSC's statement that it intends to hire [deleted]% of the incumbent's staff include Contract Administration labor? If so, what would the impact be on employee retention?"

By letters dated May 2, Hughes and CSC each responded to the contracting officer's list of weaknesses and/or deficiencies by submitting revised proposals. Hughes explained that in light of the contracting officer's discussion questions, it increased its total direct labor costs for IS and CA personnel for the first contract year by approximately [deleted] percent by re-mapping its labor categories, by including actual rates of key personnel, and by escalating its direct labor rates for the first contract year. CSC basically increased the direct labor rates for CA personnel, but made no adjustments to the direct labor rates for IS personnel. On a percentage basis, the Hughes revised direct labor rates were approximately [deleted] percent above the agency's historical rates, and CSC's revised direct labor rates remained approximately [deleted] percent below those historical labor rates. Tr. at 45.

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[7]The contracting officer also noted the following technical weakness/deficiency for the Hughes initial proposal: "It is not clear how you can achieve your goal of [deleted]% incumbent retention with your proposed labor rates."

Following oral discussions with each competitive range offeror,[8] the contracting officer requested best and final offers (BAFO). In their respective BAFOs, dated July 1, Hughes and CSC maintained the direct labor rates for IS and CA personnel as reflected in their respective revised proposals.

The final cost evaluation report stated the following with respect to Hughes (and another offeror):

> [W]e compared proposed labor rates to historical labor data which we escalated. Both Hughes and [offeror X] stated that they intend to hire [deleted] percent of the incumbent's staff. Based on that we felt it a weakness in that their labor rates appeared low if they were to be successful in fulfilling that proposal. The Contract Negotiator advised both firms of our finding, and both increased their labor rates. In so doing, they exceeded the labor rate that we considered necessary to attract and retain incumbent staff by [deleted]%. Potentially, the labor rates now proposed for each may be overstated slightly, but we do not consider a downward adjustment to establish cost realism necessary for the following reasons: Hughes and [offeror X] made business decisions to significantly increase their labor cost; the Technical Evaluation Team has rated Hughes and [offeror X] high in their ability to attract and retain quality staff; and [the incumbent contractor] has indicated that incumbents will not be available to a successor contractor which could necessitate a non-incumbent to employ considerable new-hires. If that occurs, Hughes and [offeror X] may have to offer higher salaries to hire and retain qualified technical staff. Accordingly, it is determined that the best and final offers of Hughes and [offeror X] are considered fair, reasonable and represent a realistic expectation of costs.

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[8] In an affidavit filed by the vice president for administration at Hughes who had oversight responsibility for the preparation of the firm's proposal, he stated that he asked contracting personnel during oral discussions whether the agency had any comments on the firm's revised direct labor rates. According to the vice president, he was advised by contracting personnel that Hughes had adequately addressed the concerns reflected in the written discussion questions, and the agency had no further concerns or comments related to the firm's direct labor rates. The vice president further stated in his affidavit, as confirmed by a memorandum to the file prepared by the contract negotiator, that two days after oral discussions were completed, he told the negotiator that Hughes was considering lowering its direct labor rates by at least [deleted] percent. The contract negotiator informed the vice president that this was a "business choice Hughes has to take." The contract negotiator advised that any changes made by Hughes to technical evaluation factor (3) would require evaluation.

With respect to CSC, the final cost evaluation report noted that "[p]roposed first year [IS] labor rates were within [deleted] percent of available market and historical average rates [deleted] first year of performance." This report further noted that CSC increased its "proposed [CA] rates substantially although three rates are still more than [deleted] percent below the historical rates [deleted] of first year performance."

Out of a possible 100 total points, the final technical score assigned to the Hughes proposal was 81.7 points and the final technical score assigned to CSC's proposal was 75.4 points. Hughes proposed a total cost of approximately $[deleted] million and CSC proposed a total cost of approximately $171 million.

The source selection official (SSO) concluded that the 6.3 point differential in technical quality between Hughes (which received the highest technical score) and CSC (which received the third highest technical score) was minimal. While the technical score assigned to CSC's proposal was lower than the technical score assigned to the Hughes proposal, the SSO considered any technical advantages in the Hughes proposal to be minimal and not worth a significantly higher cost (of approximately $[deleted] million). The SSO pointed out that there were no areas in CSC's proposal which the technical evaluators determined presented major weaknesses or a performance risk. Notwithstanding that under the RFP technical evaluation factors were more important than an offeror's costs, the SSO determined that the $[deleted] million in cost savings associated with CSC's proposal clearly outweighed any small technical advantage possibly offered by the Hughes proposal. Accordingly, the SSO awarded the contract to CSC as the offeror submitting the most advantageous proposal.

Hughes challenges the agency's evaluation of cost realism, conduct of discussions, and source selection decision.

Agencies must perform cost realism analyses in selecting awardees for contracts where the cost to the government is not fixed. Vitro Corp., B-261662.2, Dec. 4, 1995, 96-2 CPD ¶ 201 at 10. Our review in this area is primarily concerned with determining whether the cost evaluation was reasonable. Id. Under a level-of-effort, cost reimbursement-type contract, the purpose of the cost realism analysis is to determine the extent to which an offeror's proposed labor rates are realistic and reasonable. ManTech Envtl. Tech., Inc., B-271002 et al., June 3, 1996, 96-1 CPD ¶ 272 at 8. The agency must perform sufficient analysis to determine the extent to which an offeror's proposed costs represent what the contract should cost, assuming reasonable economy and efficiency. Id.

While a reasonably derived agency estimate of direct, unburdened labor rates for comparable labor categories, based upon historical experience, can provide an objective standard against which proposed rates may be compared, an agency may not mechanically apply that estimate to determine evaluated costs. United Int'l Eng'g, Inc. et al., 71 Comp. Gen. 177, 185-186 (1992), 92-1 CPD ¶ 122 at 11. It may well be that in some instances an estimate has limited applicability to a particular company, and in those instances, any absolute reliance upon estimates could have the effect of arbitrarily and unfairly penalizing the firm and depriving the government of the benefit available from such a firm. Accordingly, in order to undertake a proper cost realism evaluation, the agency must independently analyze the realism of an offeror's proposed costs based upon its particular approach, personnel and other circumstances. Id.

Here, the agency's approach to evaluating cost realism was to use the incumbent's historical labor rates as the benchmark for what the agency thought the offerors would need to pay in direct labor rates. Tr. at 17. The record shows that the cost evaluators mechanically compared the Hughes and CSC proposed labor rates to the historical labor rates without considering the particular offeror's technical approach or other information in the proposal. The approach taken by the agency substantially overstated the lack of realism in Hughes' proposed labor rates.

In this case, the agency has failed to meaningfully explain in the record or during the hearing why it concluded that the Hughes initially proposed labor rates (overall [deleted] percent deviation) were "significantly below" historical labor rates and not realistic, but that CSC's initially proposed labor rates (overall [deleted] percent deviation) were realistic as they "approximate[d]" historical labor rates. More specifically, the agency made no attempt to evaluate if the Hughes proposed labor rates were realistic based on the firm's proposed approach to the work as described in the firm's technical proposal.

We point out that the record shows that the [deleted]. We think the agency's failure to meaningfully consider the impact of Hughes separately escalating its first-year labor rates in its cost realism analysis was arbitrary.

In addition, the agency has not explained why, in the context of a cost-reimbursement contract, it had no concern about the awardee's proposed rates being, on average, [deleted] percent below historical rates overall (especially where some proposed rates for particular categories were apparently more than [deleted] percent lower than historical rates). As explained above, after noting that the protester's final rates exceeded the level that the agency considered necessary to retain incumbent staff, the agency's final cost evaluation report noted that Hughes might "have to offer higher [than historical] salaries to hire and retain qualified technical staff." If that conclusion were correct for Hughes, we fail to see how the agency could conclude that CSC's rates (which were below the historical rates) would allow that firm to hire and retain qualified technical staff. Nowhere in the record in this case, including the hearing transcript, do we see a reasonable basis for the agency's acceptance of the realism of CSC's considerably lower rates, and we conclude that this aspect of the evaluation lacked a reasonable basis.[9]

The record further shows that because of the flawed cost evaluation, discussions were not meaningful. Agencies are generally required to hold meaningful discussions with all competitive range offerors, and this obligation to conduct meaningful discussions is not satisfied where an agency misleads an offeror or conducts prejudicially unequal discussions. National Medical Staffing, Inc., B-259402, B-259402.2, Mar. 24, 1995, 95-1 CPD ¶ 163 at 3.

Here, as explained above, the agency concluded that the Hughes initially proposed labor rates, which were, on average, [deleted] percent below historical labor rates, were "significantly below" those rates and therefore not realistic,[10] but that CSC's initially proposed labor rates (overall [deleted] percent lower than historical rates) were realistic as they "approximate[d]" historical labor rates. Since the agency thus apparently believed that CSC's [deleted] percent deviation was not significant, we view the agency's concern about the protester's [deleted] percent deviation as a relatively limited concern. Although, as discussed above, the agency was apparently aware that the Hughes [deleted], the agency's discussion questions were not limited to the escalation issue, but rather also raised an issue concerning the level of the Hughes direct labor rates across the board, both on the cost side and the technical side (raising concern about the protester's ability to retain staff at the proposed rates). Because the discussions thus suggested two separate cost concerns (escalation as well as the overall level of the rates), they appear to have induced Hughes not only to escalate its first-year direct labor rates, but also to then increase

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[9]During the hearing, when asked to explain how the agency reconciled the evaluation of the Hughes and CSC revised labor rates in terms of retention of incumbent employees, the chair of the CBET stated that "in [his] professional judgment they were both sufficiently close to historical information for a five-year reimbursable estimated cost of a contract. . . . [To him,] they were both sufficiently close. One's slightly under and one's slightly over, but [he] was comfortable with either offer." Tr. at 57. In its post-hearing comments, the agency simply references the percentages by which the Hughes and CSC revised labor rates were respectively above and below historical labor rates. These responses do not provide a reasonable basis for the agency's failure to evaluate how CSC's proposed labor rates would affect the agency's previously expressed concern with high incumbent retention, particularly when contrasted with the agency's expressed concern about the [deleted] percent difference between CSC's rates and those initially proposed by Hughes.

[10]Analyst A commented at the hearing that a contracting officer's technical representative, "who has departed," stated that "it would be very difficult [for Hughes] to retain people at [the Hughes initially proposed labor] rates." Tr. at 62.

these rates across the board. Because the discussion questions thus materially overstated the agency's relatively limited concern about the Hughes rates, they were misleading.

In addition, we think the agency misled Hughes during discussions by overstating the agency's concern that Hughes had proposed understated labor rates. Even as to the Hughes labor rates (as opposed to the escalation issue), the agency had no basis for concern about the CA rates, which were closer to historical rates than were CSC's--yet the agency did not disclose to Hughes that its concern was limited to IS rates. Indeed, the agency led Hughes to believe the opposite, since the direct labor rate discussion question stated that the Hughes proposed first-year labor rates by category were lower "in many instances" than the agency's historical data. As confirmed by the chair of the CBET in the agency's post-hearing comments, Hughes did not have access to historical labor rates and was not told which particular labor categories were underpriced in relation to historical labor rates. Although the agency was aware of which of the Hughes labor categories were underpriced based on cost analyst A's category-by-category comparison of the Hughes proposed labor rates to historical labor rates (the analyst noting the labor categories involved more senior positions), Hughes had no idea which of its labor categories were of concern to the agency. As a result of the agency's "in many instances" discussion question and the technical discussion question indicating that Hughes had, on an overall basis, understated its labor rates for purposes of retaining [deleted] percent of incumbent personnel, we think Hughes had no choice but to assume that its labor rates were too low across the board, as opposed to too low for particular labor categories. For these reasons, in order to be responsive to both the agency's cost and technical concerns, we think it was reasonable for Hughes to understand that it needed to increase its labor rates across the board for all labor categories. To the extent the agency argues that it intended by these discussion questions to simply verify or clarify the basis for the Hughes labor rates as proposed, we think its discussion questions were materially misleading.

Our Office will not sustain a protest unless the protester demonstrates a reasonable possibility that it was prejudiced by the agency's actions, that is, unless the protester demonstrates that, but for the agency's actions, it would have had a substantial chance of receiving the award. McDonald-Bradley, B-270126, Feb. 8, 1996, 96-1 CPD ¶ 54 at 3; see Statistica Inc. v. Christopher, 102 F.3d 1577, 1581 (Fed. Cir. 1996).

The record shows that the Hughes revised proposal was scored higher than CSC's revised proposal for each of the five technical evaluation factors. With respect to technical evaluation factor (3)--professional employees compensation plan--the record shows that as a result of increasing its direct labor rates, out of a possible [deleted] points, the Hughes proposal received the highest number of points--[deleted]. CSC's proposal received the third highest number of points--[deleted]. On an overall basis, out of a possible 100 points, Hughes received the highest total technical points--81.7, and CSC received the third highest total technical points--75.4. If not for the misleading discussions, Hughes contends it would not have raised its rates as much (and certainly not on an across-the-board basis). Even if such a more limited rate increase meant that Hughes received only the same number of points for technical evaluation factor (3) as did CSC, Hughes still would be the highest technically rated offeror, while its proposed costs would have dropped. The protester's lower proposed costs could well have led to a different source selection, although we, of course, cannot know precisely what the direct labor rates for Hughes and CSC would have been, if the agency had conducted meaningful discussions. While there is no way to predict the result of such a speculative technical/cost tradeoff, we conclude that the record establishes that there is a reasonably possibility that Hughes was prejudiced by the agency's actions. See Eldyne, Inc., B-250158 et al., Jan. 14, 1993, 93-1 CPD ¶ 430 at 7.

Accordingly, we recommend that the agency first reevaluate the proposals for cost realism, and then reopen discussions, consistent with this decision, and request another BAFO from, at a minimum, Hughes and CSC. If an offeror other than CSC is selected for award as a result of the agency's reevaluation, the agency should terminate CSC's contract for the convenience of the government. We also recommend that Hughes be reimbursed its costs of filing and pursuing its protest, including reasonable attorneys' fees. 4 C.F.R. § 21.8(d)(1) (1997). Hughes should submit its certified claim for such costs, detailing the time expended and cost incurred, directly to the contracting agency within 60 days of receiving this decision. 4 C.F.R. § 21.8(f)(1).

The protest is sustained.

Comptroller General
of the United States