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Decision

Matter of: International Outsourcing Services, LLC

File: B-295959

Date: May 25, 2005

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DIGEST

The elimination of the protester's proposal from the competition for the award of a fixed-price contract is unobjectionable where the agency reasonably determined under the solicitation's price realism evaluation factor that the protester's proposed price was unrealistically low and the agency was reasonably concerned that the protester's contract performance may therefore be adversely affected.

DECISION

International Outsourcing Services, LLC (IOS) protests the rejection of its proposal and the award of a contract to NCH Marketing Services under request for proposals (RFP) No. HDEC08-04-R-0019, issued by the Defense Commissary Agency (DeCA), for coupon redemption services. The protester argues that the agency's evaluation of its proposed price as unrealistic, and the resultant rejection of its proposal, were unreasonable.

We deny the protest.

DeCA commissaries provide "for the resale of groceries and household supplies at the lowest practical price (consistent with quality) to members of the military services, their families and other authorized patrons" at locations worldwide. Contracting Officer's Statement at 1. In performing this mission, the RFP here estimates that the commissaries will receive 160,000,000 coupons for merchandise, which DeCA "must redeem for cash from the manufacturer who issued the coupon." Id. at 1-2. The successful contractor here will be required to provide all

management, supervision, labor, equipment, materials, supplies, facilities and transportation necessary to audit, count, sort, and forward coupons and invoices to the issuing manufacturers.

The RFP provided for the award of a fixed-price indefinite-quantity contract, with a base period of 1 year and four 1-year option periods, to the offeror submitting the proposal determined to represent the “best value” to the government based upon the evaluation factors of “performance capability” and “price.” RFP at 15. The RFP specified that the performance capability and price factors would be considered equal in importance, and that the performance capability factor was comprised of the following three subfactors: technical capability, personnel, and past performance.¹ The RFP (at 16) also provided that proposals would be evaluated under the price factor as follows:

Proposals will be evaluated to determine whether offered prices are realistic in relation to the work to be performed, reflect a clear understanding of the requirements, and are consistent with other portions of the offeror’s proposal. The PRICE factor will not be scored. Price will be evaluated by adding the total price of all line items, base year plus four one year options.

The solicitation required that proposals include, among other things, a technical capability and personnel proposal, and a past performance proposal. Offerors were informed that their technical capability and personnel proposals were to include plans for accomplishing the coupon redemption services, staffing, and subcontracting, as well as narratives regarding the qualifications of key personnel. Past performance proposals were to include information regarding contracts performed in the past 3 years and references.

With regard to price, offerors were to complete the schedule set forth in the RFP as amended. In order to complete the schedule, offerors were to insert a unit price per thousand coupons for the services required, as well as an extended price based upon the agency’s estimate of 160,000,000 coupons per year, for each of the five contract periods (base plus four options). Although the schedule included line items for each contract period for the reimbursement of shipping and handling fees incurred by the contractor, the RFP explained that the successful contractor would be reimbursed only “the amount reimbursed from the manufacturers,” and that offerors thus were not to insert prices for the shipping and handling line items. RFP at 4; see RFP at 45 (“DeCA shall only reimburse the contractor for payments received from

¹ The RFP also listed evaluation “elements” under each of the evaluation subfactors, and stated that the technical capability subfactor was significantly more important than the personnel and past performance subfactors, which were approximately equal in importance.

manufacturers for postage/special shipping and handling fees invoiced. If manufacturers do not pay the postage/special shipping and handling fees invoiced, then DeCA does not reimburse the contractor”).

The agency received proposals from only NCH and IOS. NCH’s proposal received a rating of “very good” under the performance capability factor with a total evaluated price of \$5.76 million, and IOS’s proposal received a rating of “satisfactory” under the performance capability factor with a total evaluated price of \$2.25 million.² Both proposals were included in the competitive range. AR, Tab 1, Initial Evaluation Summary, at 5.

Discussions were conducted, during which the agency posed written questions to IOS regarding its technical capability, past performance, and price, and IOS submitted a revised proposal.³ With regard to price, the agency informed IOS that its “price seems extremely low” and “do[es] not seem to be realistic for the work to be performed.” The agency requested that IOS “explain and provide backup documentation as to how [IOS] arrived at the price and how [IOS] can successfully perform in accordance with the Statement of Work (SOW) at that price.” AR, Tab 6, Agency Discussion Letter to IOS (July 14, 2004), at 1.

IOS responded by providing a relatively detailed explanation of the costs comprising its price. Specifically, IOS explained that its “bid was based on the incremental cost of processing DeCA coupons,” and that IOS had used this approach because “the plant where we will process DeCA has excess installed capacity that will be more than adequate to process the estimated DeCA volume.” The protester included a chart as part of its explanation that provided a “simplified version of [IOS’s] cost analysis adding only the incremental cost associated with the additional DeCA volume.” The chart included, among other things, various personnel costs [DELETED] and costs for [DELETED], as well as costs associated with [DELETED]. The chart provided, for example, total labor costs of [DELETED] per year, and costs associated with [DELETED]. The chart provided an estimated total annual cost of performance of [DELETED], and total fees to be collected annually for performance of the contract of [DELETED]. AR, Tab 6, IOS’s Response to Discussions (July 24, 2004).

² NCH proposed unit prices of [DELETED] for the base and first option periods, [DELETED] for the second and third option periods, and [DELETED] for the fourth option period, and IOS proposed unit prices of [DELETED] for the base period, [DELETED] for the first option period, and [DELETED] for each of the remaining three option periods. Agency Report (AR), Tab 1, Initial Evaluation Summary, at 3.

³ IOS’s final revised proposal received a rating of “very good” under the performance capability factor.

IOS indicated that the [DELETED] in fees it anticipated collecting consisted of fees collected from DeCA for the performance of the contract and “special handling” fees IOS anticipated that DeCA would collect from manufacturers whose coupons IOS redeemed. IOS stated that it had calculated the collection of an average of [DELETED] per year in fees from DeCA based upon its average price to the agency of [DELETED] per 1,000 coupons processed, and the agency’s then-estimated total number of coupons of 200,000,000 per year.⁴ IOS also stated that it anticipated collecting an additional [DELETED] in fees from manufacturers for coupons that required “special handling.” In this regard, IOS explained as follows:

Coupons that do not comply with industry UPC [Universal Product Code] codes, don’t have codes, or have the wrong codes increase our processing costs. Special handling fees have become common as a way to recover some of the increases associated with processing these hard to handle coupons. Based on our experience with other accounts, the average amount of special handling fees that will be paid by manufacturers is [DELETED]. The billing of special handling fees will be only on coupons not scanned. For calculation purposes, we estimate that 10% of DeCA coupons will not be scanned and therefore will have special handling added to these invoices.

AR, Tab 6, IOS’s Response to Discussions (July 24, 2004). Consistent with this explanation, IOS’s chart provided for the collection of [DELETED] in special handling fees based upon 20,000,000 coupons requiring special handling at the price of [DELETED] per 1,000 coupons. IOS’s response also provided other reasons in support of its anticipated costs and proposed price, including, among other things, its “investment in technology,” including its “high-speed automated sorting machines” and “new scanning equipment.” Id.

The agency evaluated IOS’s response, and informed IOS during a second round of discussions that the agency was “still concerned with [IOS’s] ability to successfully perform at the unit prices proposed, based on historical prices [DeCA has] experienced in the last 10 years.” The agency proceeded to raise a number of specific concerns with IOS. For example, the agency informed IOS that “[a]lthough DeCA has estimated an annual number of coupons to be processed for the base year through the option years, industry is showing a decrease in volume of coupons redeemed,” and that because of this, the agency was concerned “that in the option years [IOS’s] prices decrease, with the volume of coupons potentially decreasing the amounts of revenue may be less than [IOS] anticipate[s].” The agency also noted that “[i]t appears that IOS is also counting on special handling fees and potential

⁴ The RFP initially estimated that DeCA would receive 200,000,000 coupons per year, and was subsequently amended to provide for the receipt of an estimated 160,000,000 coupons per year.

postage reimbursements to cover overall cost of performance,” and pointed out that as set forth in the RFP “[t]he line items for Postage and Shipping/Handling Fees [are] not guaranteed and should not be considered when determining [IOS’s] cost.” The agency thus requested that IOS “acknowledge that [it] understand[s] that postage reimbursements and special handling fees are only reimbursed to IOS for the amount that the manufacturers pay to DeCA.” AR, Tab 6, Agency Discussion Letter to IOS (Sept. 8, 2004), at 1.

The protester responded to each of the specific concerns raised by the agency, noting, for example, that it watches “redemption trends throughout North America very closely,” and that “[a]lthough redemptions are on the decline we know the decline is very retailer specific.” The protester provided further explanation regarding its views of redemption trends, and stated that in preparing its proposal it had “accommodated for a slight drop in annual volume of between 5 – 10%.” With regard to the agency’s concerns regarding IOS’s anticipated receipt of shipping and handling fees during performance of the contract, the protester explained that while it understood that the shipping and handling reimbursements were not guaranteed, it could not “ignore what the facts have shown us over the past years,” and included certain information in support of its position. The protester concluded by stating that it had “made a conscious effort to put forth the best pricing available to DeCA for processing its retail coupons,” and that IOS has “a proven track record of providing the best service at the lowest price.” The protester pointed out in this regard that it is the “processor of choice for over 75% of all retailers who accept coupons in the United States representing over 60% of all coupons redeemed.” AR, Tab 6, Protester’s Discussions Response (Sept. 17, 2004).

The contracting officer ultimately determined that NCH’s proposal represented the best value to the government, and met with the cognizant DeCA contract review board (CRB) to discuss the contracting officer’s determination, as well as the fact that in the contracting officer’s view she “had not been able to determine that IOS’s price was reasonable and therefore had the ability to successfully perform the work at the proposal price.” Contracting Officer’s Statement at 10. The CRB informed the contracting officer that in the CRB’s view “a best value trade-off determination was between two qualified offerors,” and that because the contracting officer had not “been able to conclude that [IOS’s] price was reasonable . . . a best value trade-off could not be made.” *Id.* at 11. The CRB thus “would not approve the selection of NCH on the basis of a best value award determination,” and recommended that “the Contracting Officer review [IOS’s] proposal to determine if it should be eliminated from the competitive range because it no longer had a reasonable chance of being selected for award.” *Id.*

The contracting officer states that “[a]fter further review of IOS’[s] proposal and explanations it provided concerning its price, [she] was unable to conclude that IOS’s price was reasonable.” Contracting Officer’s Statement at 10. She concluded that IOS’s continued reliance on reimbursement for special shipping and handling

fees that were not guaranteed “place[d] an unacceptable risk on DeCA that as IOS[’s] costs exceed its reimbursement income that it will not be able to continue contract performance.” AR, Tab 6, Contracting Officer’s Determination to Eliminate IOS from the Competition, at 3. The contracting officer noted in another section of the determination that “DeCA’s analysis of historical data indicates that DeCA’s volume of special handled coupons and the payments received from manufacturers varies between manufacturers and amounts paid,” and “that many companies disallow any additional costs for special handling according to their coupon redemption policies.” *Id.* at 4. Because of this, the agency determined that IOS’s estimate regarding its anticipated reimbursement for special handling fees “could not be verified” and that IOS’s position was “unrealistic.” *Id.* The contracting officer also commented here that IOS’s proposed costs for [DELETED] were “unrealistic” because, in the contracting officer’s view, “there should be costs for equipment replacement and maintenance over the life of the contract.” *Id.* at 3. The contracting officer ultimately concluded “that award to IOS would pose an unacceptable risk” because the agency could not determine that IOS’s price was realistic, and eliminated IOS’s proposal from the competition on that basis. *Id.* at 5. After being informed of this, IOS requested and received a debriefing. This protest followed.

IOS protests the agency’s rejection of its proposal. IOS contends that the agency’s determination that its proposed price was unrealistically low was not reasonably based, and that, in any event, its proposal should not have been eliminated from the competition.⁵

⁵ IOS also argued in its initial protest to our Office that the agency had failed to engage in meaningful discussions with IOS regarding the agency’s concerns with IOS’s proposed price and its reliance in part on its reimbursement of the special handling fees. In its report, the agency responded to IOS’s argument and provided numerous documents detailing its conduct of discussions with IOS. Because the protester did not respond in its comments to the agency’s position that its discussions with IOS were meaningful, we consider IOS to have abandoned this aspect of its protest. *Uniband, Inc.*, B-289305, Feb. 8, 2002, 2002 CPD ¶ 51 at 5 n.3.

Additionally, IOS argued for the first time in its comments on the agency report that the agency acted improperly in performing its price realism analysis because, in the protester’s view, the agency requested that IOS provide more information than was necessary to perform the price realism analysis. Protester’s Comments at 3; *see* Federal Acquisition Regulation (FAR) § 15.402(a), 15.403-3 (in establishing the reasonableness of proposed prices or determining cost realism, the agency “should not obtain more information than is necessary”). Because the protester was clearly aware during the discussions process what information the agency was requesting, this argument, raised by the protester for the first time in its comments on the report, is untimely and will not be considered. 4 C.F.R. § 21.2(a)(2) (2005).

Although agencies are required to perform some sort of price or cost analysis on negotiated contracts to ensure that proposed prices are fair and reasonable, where, as here, the award of a fixed-price contract is contemplated, a proposal's price realism is not ordinarily considered, since a fixed-price contract places the risk and responsibility for contract costs and resulting profit or loss on the contractor. However, an agency may provide in the solicitation for a price realism analysis for such purposes as measuring an offeror's understanding of the solicitation requirements, or to avoid the risk of poor performance from a contractor who is forced to provide goods or services at little or no profit. The depth of an agency's price realism analysis is a matter within the sound exercise of the agency's discretion. Citywide Managing Servs. of Port Washington, Inc., B-281287.12, B-281287.13, Nov. 15, 2000, 2001 CPD ¶ 6 at 4-5. In reviewing protests challenging price realism evaluations, our focus is whether the agency acted reasonably and in a way consistent with the terms of the solicitation.

The protester first argues that under the solicitation its proposal cannot be rejected as unacceptable because its price was considered unrealistically low. However, as indicated, the solicitation expressly provided that "[p]roposals will be evaluated to determine whether offered prices are realistic," and specifically informed offerors that the analysis would include the distinct queries of whether the prices were realistic "in relation to the work to be performed, reflect a clear understanding of the requirements, and are consistent with other portions of the offeror's proposal." RFP at 16. Accordingly, this is not an instance, such as pointed to by the protester in Possehn Consulting, B-278759, Jan. 9, 1998, 98-1 CPD ¶ 10, where the rejection of a proposal because its pricing was found to be unrealistic was determined to be a matter of responsibility due to the solicitation's lack of any evaluation factor or criterion related to price realism. See also CSE Constr., B-291268.2, Dec. 16, 2002, 2002 CPD ¶ 207 at 4-5 (where there is no relevant evaluation criterion pertaining to price realism or understanding, a determination that an offeror's price on a fixed-price contract is too low generally concerns the offeror's responsibility). In our view, given the RFP's specific provision regarding the performance of a price realism analysis, as well as the remainder of the RFP's terms, the agency could reject a proposal that lacked price realism, or consider a proposal's lack of price realism in its source selection.

The protester also argues the agency's price realism determination was flawed, given that IOS's revised proposal was evaluated as "very good" under the performance capability factor, and that the record of the agency's evaluation does not indicate that the agency had any concerns regarding IOS's understanding of the agency's requirements. This argument provides no basis to find the evaluation unreasonable or improper here. This is so because, as indicated above, although one aspect of the solicitation's announced price realism analysis focused on whether the offerors' pricing reflected a clear understanding of the agency's requirements, the first of the announced aspects concerned whether the proposed prices were realistic "in relation to the work to be performed."

Turning to the reasonableness of the agency's evaluation under the price realism evaluation factor, the parties acknowledge that the propriety of this aspect of the agency's evaluation hinges upon whether the agency had a reasonable basis for discounting IOS's claim that it would be able to recover a significant portion of its costs through the billing of manufacturers for special handling fees for an estimated 10 percent of coupons redeemed. In this regard, we note that the record reflects, and IOS does not deny, that its proposed price to the agency for the processing of the coupons is below cost. Specifically, IOS's responses during discussions establish that IOS's proposed price to the agency of, on average, [DELETED] per 1,000 coupons for a total annual price of [DELETED], was not sufficient to recover IOS's estimated costs of [DELETED]. IOS's position is that it would recover its costs and make a profit in performing the contract with its below-cost price for the services because IOS would derive additional revenue from the manufacturers' payment of special handling fees.

As detailed above, the issue of the protester's planned recovery of these fees was raised during discussions. In this regard, because the agency was unaware of special handling fees in the amount proposed by IOS being paid by manufacturers, it requested that the protester provide "the name and price per 1,000 coupons for at least three (3) references that are similar to DeCA" in support of IOS's claim that its "bid [was] consistent with other retailers [IOS] process[es] of similar volume and program requirements," and that "[b]ased on [IOS's] experience with other accounts, the average amount of special handling fees that will be paid by manufacturers is [DELETED]/1000." AR, Tab 6, Agency Discussion Letter to IOS (Sept. 8, 2004); IOS's Response to Discussions (July 23, 2004).

The protester responded by providing a letter that listed for each of four retailers (identified as retailers "A", "B," "C," and "D") an approximate annual volume of coupons processed, and a total dollar amount comprised of "Processing Fee + Shipping Reimbursement" per thousand coupons processed. For example, the letter provided that for retailer "A" IOS processed approximately [DELETED] million coupons per year, for [DELETED] per thousand coupons, with the [DELETED] representing a total of the processing fee charged plus IOS's recovery of shipping and handling fees. AR, Tab 6, IOS's Response to Discussions (Sept. 17, 2004).

This letter did not, however, identify in any manner what amount or percentage of the dollar amount listed as recovered by IOS was attributable to the collection of IOS's processing fee, and what amount or percentage was attributable to IOS's recovery of shipping and handling fees. As such, the agency understandably could not verify from the information provided by IOS that its proposed collection of a [DELETED] special handling fee for 10 percent of the coupons processed for DeCA was in fact consistent with IOS's commercial contracts, or consistent with IOS's claim that manufacturers had previously paid special handling fees at this rate. Given that the agency was unaware from its experience that the collection of [DELETED] in special handling fees either had occurred in the past or was probable,

and the protester's failure to allay the agency's concerns here with any specific information other than the protester's claim that based on its "experience . . . the average amount of special handling fees that will be paid by manufacturers is [DELETED], we cannot find the agency's skepticism and ultimate determination that this aspect of IOS's proposed pricing was unrealistic to be unreasonable.

In determining to therefore reject IOS's proposal, the contracting officer was concerned that because of IOS's reliance on the special handling fees for a significant percentage of its revenue, and that the collection of those fees, particularly in the amount anticipated by IOS, was not guaranteed, that "IOS's costs would exceed its revenue" and that this would "place[] successful contract performance at risk." AR, Tab 6, Contracting Officer's Determination to Eliminate IOS from the Competition, at 2. The contracting officer added that "as IOS[s] costs exceed its reimbursement income . . . it will be unable to continue contract performance," and that this would "adversely effect DeCA's ability to operate." Id. at 3. The contracting officer concluded that because of this an "award to IOS would pose an unacceptable risk" to the agency. Id. at 5.

We have found that the risk of poor performance when a contractor is forced to provide services at little or no profit under a fixed-price contract is a legitimate concern that can be considered under a price realism evaluation. Ameriko, Inc., B-277068, Aug. 29, 1997, 97-2 CPD ¶ 76 at 3; GEC-Maconi Electronic Sys. Corp., B-276186, B-276186.2, May 21, 1997, 97-2 CPD ¶ 23 at 5. Here, the agency reasonably found IOS's price to be unrealistic, and because of this, determined that there was a significant risk that IOS's performance under the contract may be so unprofitable that the performance of this contract--which is considered extremely important to

DeCA--would be adversely affected.⁶ Under the circumstances, we find the agency had a reasonable basis to reject IOS's proposal.

The protest is denied.

Anthony H. Gamboa
General Counsel

⁶ The agency explains that "DeCA pays for the merchandise it orders from a revolving fund (Defense Working Capital) fund and is required to reimburse the fund and does so with the proceeds from the sale of the merchandise." Contracting Officer's Statement at 1. The coupons DeCA receives from customers "are an accountable item" and are thus treated by DeCA "as cash equivalent and the redemption of the coupons is required to reimburse the revolving fund." *Id.* Given the RFP's estimate as to the number of coupons to be redeemed, and the average face value of the coupons, DeCA estimates that the annual value of the coupons redeemed totals \$115.2 million. DeCA thus concludes that "[a]s can be seen from the coupon volume and dollars they represent, the successful performance of the coupon redemption contract is extremely important to the financial health of [DeCA]." *Id.* at 2.