

April 18, 2000

PBC

PROCUREMENT INFORMATION BULLETIN (PIB)

MEMORANDUM FOR DISTRIBUTION LIST--ALL FSS PROCURING ACTIVITIES

FROM: NICHOLAS M. ECONOMOU, CPPO
DIRECTOR
FSS ACQUISITION MANAGEMENT CENTER (FCO)

SUBJECT: Procurement Information Bulletin 00-10

FAIR AND REASONABLE PRICES

AND THE

MAS PRICING POLICY

The negotiated prices in MAS contracts must be fair and reasonable!

Customers should not have to haggle for better prices when buying from the schedule within the maximum order. A basic part of FSS's responsibility to our customers is to determine the contract prices as fair and reasonable. The MAS schedule must represent more to our customers than a virtual yard sale.

The fact that agencies can ask for additional discounts should not impact your tolerance for high prices. It is erroneous to allow prices higher based on the theory that agencies will negotiate better prices on individual orders. Equally false is the argument that the vendors, unknown to us, are actually offering better prices,

therefore; a higher contract price is OK.

Higher prices based on this logic undermines the creditability of the MAS program. You may have heard or seen vendors (both contract and open market) advertise that their prices are "X percent better than GSA." Every time you see or hear such a claim, it is a direct attack on the MAS program.

Our customers receive or hear those ads! Their own experience may support the concept that our contract prices are no more than a Government suggested list price. When this is the case, these buyers will view our assurance of price reasonableness as no more than legal cover, separate from reality.

Now that the price reduction clause allows agencies to negotiate better pricing, why is the MAS contract price important?

If MAS contract prices can be routinely undercut, then FSS is not using the total volume of Government buying to achieve better prices for our customers. Taking advantage of the total volume of Government demand is the statutory justification for FSS and the schedules program. When we lose that, we easily could lose the program.

How can commercial firms routinely undercut MAS contract prices?

Because we did not negotiate to the most favored customer, or we placed our common sense on hold. When we negotiate to the best pricing, with only reasonable considerations for differences, vendors will not have the fat margins against which to give additional discounts. When asked for additional discounts from agencies on routine buys, the vendors will have to say, "No, the schedule price is our best price."

Aren't we supposed to exclude from negotiation objectives those commercial agreements with different terms or conditions from the MAS?

NO! GSAM 538.270(c), MAS pricing policy, clearly states that you are to evaluate differences for terms and conditions. DO NOT IGNORE THEM.

Is the total value of the contract really a fair criterion, when each agency makes an additional ordering decision?

Yes! The vendor's ability to sell to the Government is greatly enhanced by having an FSS contract. The Government is a huge

market. It is a common experience for vendors to state that they cannot effectively sell to Government agencies without a MAS contract number. The contractors should make major concessions to have enhanced access to that market. As noted above, using the total purchasing power of the Government is the whole purpose of the schedule program.

What about claims from vendors that selling to the Government costs more?

Follow the policy. Do not just accept or ignore the vendor statements, evaluate them. Ask for proof. Consider the full scope and value of the contract, and don't be distracted by individual stories of difficult sales or unyielding Government buyers. A few unique instances do not change the overall reality.

Keep in mind, the vendor's major commercial customers are demanding and not always perfect. We are to compare the Government to commercial customers, with all their flaws, not some ideal customer. Many of the complaints contractors have with the Federal customer, they have with their commercial customers.

1. The Government has isolated outposts that have to be covered, unlike most customers.

According to Office of Personnel Management data approximately 56 percent of all Government employees are located in the top twenty-five major metropolitan areas, with 31 percent in the Washington-Baltimore area. This level of dispersion is consistent with most commercial firms. For the population as a whole, only 51 percent of the population live in the top 40 metropolitan areas. The fact is most large commercial customers are equally dispersed as the Government. Isolated locations do not tend to be large consumers; therefore, any extra cost entailed in servicing them can be absorbed by the larger sales in metro.

Most state contracts provide coverage for all local municipalities. Because their large cities tend to negotiate their own agreements, state contracts would tend to be more dispersed than the Federal

Government. Despite this fact, vendors have used the argument when comparing to states with substantial isolated areas, such as California, Washington, Idaho and Hawaii.

2. The MAS contract does not have a commitment to purchase anything.

This is legitimate for a new contractor who is entering into an unknown market. Often, the best response is to include provisions to adjust the pricing based on the contract's success.

Less creditability can be given to this issue for established contractors. An established history of contract sales and the growing use of MAS contracts provides significant security to the contractors. Most commercial guarantees are based on similar histories of sales without enforced penalties. Where you determine this is a real issue, you should obtain contract wide step discounts or end of year discounts based on total sales, as discussed in PIB 98-21.

3. Are State governments so different they must be excluded?

3.

In fact, states are so similar they must be considered (see PIB 98-15). Most of the excuses given for states getting better prices can be summarized into, "they are more effective at using their combined buying power than we are."

Sole vendor guarantees are often claimed for not considering state contracts, however; often these guarantees are illusionary. Some state variations include a sole vendor by brand name (leaving the competition between brands), awarding such a wide variety of products that they are effectively competing with one another, or hinting that the award may be sole source, but not guaranteeing it.

Does the requirement to evaluate differences apply to services?

Absolutely. When comparing the price of services with prices that

similar services were sold earlier, you should consider differences, such as those shown below. As with products, you should neither insist on equality with a lowest price nor totally disregard comparisons. Adjusting prices should be based on factual information, and not one-time examples of extreme situations (anecdotal evidence).

1. Skill levels. Skill level classifications represent a group of employees with similar skills that are uniformly priced. Where the groupings proposed are the same as the offeror uses commercially, they can be the basis of negotiations. However, where the offeror proposes unique classifications, or where the offeror has limited commercial sales, greater care must be given. The negotiator must look critically at the price differences within the group. One or two members should not be outside the general price range of the group. If they are either, move them to a more appropriate group and delete them from the group rate calculation. When a "mean", simple average is used to price a specific level of a labor category, the spread of prices within the category should be limited. Too broad a range allows contractors to substitute lower priced employees for higher priced employees while being paid at the same rate. List the members by price. When there is more than one cluster of prices and the differences are significant, negotiate as separate categories.

Another good test, after you list the members in order by price, is to count down to the mid-point (median) and finally find the price that occurs most often (mode). If these three numbers (mean, median and mode) are approximately equal, you have a good grouping; if not, divide the group into more homogeneous units. The mode (occurs most often) is usually the best average for negotiations, as it probably best represents the workers who will do most of the work.

Finally, make sure the members of your skill levels work approximately the same number of hours. Where there is a wide variation in hours between employees, a weighted average, (price times hours worked) rather than a simple average should be used.

2. Special Qualification certifications and licenses. Within a labor category, certifications and licenses can result in higher pricing levels: e.g. CPAs in accounting, specific system qualifications for computer system analysts. These differences should be apparent on their comparable sales information. Where the evidence supports differences, we can accept them as sub factors within the class.

Care should be taken to apply the sub factors only where appropriate. For example, a CPA may be the price factor for a junior accountant, but for a senior accountant it is either expected or a requirement, therefore; senior accountants would not have a differential. Another example, being "Oracle qualified" may be a price determining factor for a system analyst, but it would not be significant for a program manager with predominately oversight and planning responsibilities.

3. Locations. The schedule program is national in scope, therefore; we look for national pricing. Especially in service, to rely on pricing from a single region to dictate nationwide pricing can lead to distortions. Labor pricing in major metropolitan areas is generally higher than in rural areas. This ranging could result in our paying too much in some areas, and contractors being unable to perform in others. The adjustment can be made by looking at the offeror's, or other contractor's, pricing information to identify area differential's pricing information. Published sources such as the Bureau of Labor Statistics data by metropolitan area, or professional publications are also good sources. Regional differentials tend to remain consistent over time, therefore; less than current information can be used to establish patterns.

4. Security clearances. Technically the chief adjustment for security clearances is the cost of obtaining a clearance. Our IT service contracts allow for the cost of security clearances as unpriced items limited to a percentage of the order price. As an alternative, on schedules where security clearances are an issue, the contracting officer should consider the cleared workers as a different class. For routine clearances, we should be willing to pay the cost of the required security clearance. A reasonable consideration would be the cost of the clearance over the hours worked for the life of the clearance. If a clearance is good for 2 years and the cost of obtaining a clearance is \$500, the price impact would be \$0.12/hour ($\$500 / (2 * 2080)$). Higher-level clearances take longer to obtain and fewer persons qualify, therefore; the value of persons with a higher level clearance will exceed the cost of obtaining a clearance. Information on the cost of clearances can be obtained from the Defense Industrial Security Service.

5. Contract types. Schedules only allow fixed prices. Fixed prices place a higher degree of risk on a contractor. In addition to issues of comparisons with cost based contracts, you should also consider

the impact on the economic price adjustment provisions. The longer a contractor is obligated to hold their prices, the greater the cost risk. Recent histories of labor prices in the industry should be considered.

Values for risk based on types of contract are discussed in FAR 15.404-4(d)(1)(ii) and GSAM 515.404-4(d)(3), Profit. Although these references are not directly applicable, they can serve as general guidelines.

SUMMARY:

Determining fair and reasonable prices for commercial items is based on price analysis, see FAR 15.404-1(a) and (b). Comparing prices is the essence of price analysis. The examples above will not solve all your issues. Additional analytical help is available from the Federal Acquisition Institute's (FAI) Contract Pricing Reference Guides I, II and III. These guides are found in the FAI campus "Library" (<http://www.faionline.com/fai/>).

In the real world, two separate events are rarely identical. Comparable sales are not identical, therefore; it is up to you to make the adjustments. The examples given along with the Pricing Guides should help you find approaches that will lead to a sound decision. Comparisons require a more sophisticated business judgment than just ignoring the differences, or discarding the pricing as not relevant; but it is a judgment that you, as a contracting officer, are required to exercise.