



**Comptroller General
of the United States**

Washington, D.C. 20548

Decision

Matter of: Alamo Aircraft Supply, Inc.; Merchants World Surplus Enterprises, Inc.

File: B-278215; B-278215.2

Date: January 7, 1998

John J. Fausti, Esq., and Stephanie L. Buser, Esq., for the protester.
Robin Walters, Esq., and Michael Malone, Esq., Defense Reutilization and Marketing Service, Defense Logistics Agency, for the agency.
John L. Formica, Esq., and James A. Spangenberg, Esq., Office of the General Counsel, GAO, participated in the preparation of the decision.

DIGEST

1. Solicitation for the sale of surplus property under a term contract is not transformed into something other than a sale because of the inclusion of a provision requiring that the successful contractor pay the government 80 percent of the net proceeds, if any, it obtains from the property in addition to its bid price.
2. Sale of surplus property is not an unauthorized sale on credit where at the time of the sale there is no credit extended or debt incurred; a provision which requires that the contractor pay the government 80 percent of the net proceeds, if any, the contractor obtains from the property does not render the transaction a credit sale.
3. A solicitation for the sale of surplus property will not result in an illusory contract because of a termination clause, where the clause does not allow the parties to terminate at will, but rather allows the parties to terminate only if certain specified contract performance thresholds are not attained.
4. Neither the financial requirements imposed by a solicitation which provides for the award of a term sale contract, nor the size, scope, or length of the contract contemplated by the solicitation, violates the requirement set forth in the Federal Property and Administrative Services Act of 1949 that solicitations for the disposal of property be "on such terms and conditions as shall permit that full and free competition which is consistent with the value and nature of the property involved," given the apparent reasonableness of the agency's explanation for the challenged provisions and the protesters' failure to substantively respond to the agency's position.

DECISION

Alamo Aircraft Supply, Inc. and Merchants World Surplus Enterprises, Inc. protest the terms of a solicitation issued by the Defense Reutilization and Marketing Service (DRMS), Defense Logistics Agency (DLA), for the sale of surplus property.¹

We deny the protest.

The solicitation represents a pilot initiative under which DRMS will award a term sale contract, with a 5-year performance period, to the high bidder for five categories of surplus Department of Defense (DOD) industrial property.² The solicitation provides for a "two-step approach," under which firms are first required to submit technical proposals in response to request for technical proposals (RFTP) No. 99-7005. The technical proposals are to include, among other things, an operational plan demonstrating the firm's "capability to market, transport, store and add value to the material," and a business plan describing the corporate and project organizations to be used in disposing of the property acquired under the sales contract, and evidencing that it had access to a \$3 million line of credit. Technical proposals were submitted by September 30, 1997.³

Those bidders whose technical proposals are found by the agency to be technically acceptable, based upon the RFTP's evaluation criteria, will be invited to submit sealed bids in response to an invitation for bids (IFB).⁴ The bids are to be expressed as a percentage of the government's established acquisition value of each category of surplus property, with the high bid being determined by multiplying the acquisition value of each category by the appropriate percentage bid, and totaling these amounts.

The successful bidder will be required to establish and fund a "stand alone" entity that will be the actual purchaser of the surplus property from the agency, and

¹We consider this protest under 4 C.F.R. § 21.13 (1997). DLA, by letter dated January 13, 1987, has agreed to our considering bid protests involving its surplus property sales. See Consolidated Aeronautics, B-225337, Mar. 27, 1987, 87-1 CPD ¶ 353 at 1 n.1.

²DRMS estimates that the surplus property that will be made available to the contractor during each year of the contract will have a market value of \$30 million.

³Neither Alamo nor Merchants World submitted a proposal.

⁴While the protesters initially contended that if the IFB is materially changed the competition may need to be reopened, they now agree that this contention is premature.

whose single purpose will be to perform the proposed contract. This entity, or purchaser, is required to provide DRMS with a performance bond of \$1 million, or establish a fund to be held by DRMS, in which 10 percent of all contractor distributions will be deposited until a balance of \$500,000 is reached. The purchaser is also required to provide a \$400,000 payment deposit, which, in addition to the contractor's \$100,000 bid deposit, will be held by the agency until completion of the contract.

The purchaser will have the right and obligation (with certain limited exceptions) to remove, upon payment of its bid price,⁵ all surplus property generated by the agency within the designated federal supply classifications set forth in the solicitation that remains after the agency's completion of the Reutilization/Transfer/Donation (R/T/D) process.⁶

The proposed contract also requires that 80 percent of the "net proceeds" the purchaser obtains by any means from the surplus property, including the purchaser's sale or lease of the property, be paid to the United States Treasury. Specifically, the proposed contract defines "net proceeds" as the purchaser's "gross proceeds" minus its "direct costs." "Gross proceeds" are defined as all proceeds obtained by the purchaser from the property, by sale, rental, or other means; "direct costs" are essentially all costs actually incurred by the purchaser solely for the management, preservation, improvement, and transportation of the property (not including the amount paid to DRMS for the purchase of the property).

For example, should the purchaser purchase surplus property from DRMS for \$5 million, incur \$12 million in direct costs in managing, preserving, improving, and/or transporting the property, and realize \$60 million in gross proceeds from the property, the purchaser would, upon realization of the \$60 million, be required to pay to the U.S. Treasury \$38.4 million, which equals 80 percent of the purchaser's

⁵As initially issued, the draft IFB stated that the purchaser would be required to pay 20 percent of the purchase price it bid to the government for the property. The agency amended the solicitation to clarify that the purchaser will be required to pay its total bid purchase price to the government for the property.

⁶DLA's disposition priorities are to (1) reutilize property within DOD, (2) transfer items to other federal agencies and organizations with equivalent priority for the purpose of obtaining excess property and (3) donate the remaining items to eligible entities such as state and local governments, among many others. This process is generally referred to as the R/T/D process. Items that remain after these priorities are served are sold to the general public, as contemplated here, or otherwise disposed of. Federal Property Disposal: Information on DOD's Personal Property Disposal Process, GAO/NSIAD-97-155BR, July 8, 1997.

net proceeds.⁷ Because of this feature--which entitles the government to 80 percent of the net proceeds, if any, realized by the purchaser from the property (in addition to the amount paid for the purchase of the property from DRMS)--the contract has been referred to by the agency as a "proceeds sharing sale."

The proposed contract also requires that the purchaser, beginning with the fourth quarter of contract performance, prepare "quarterly reports" setting forth "performance ratios" depicting the rate of return resulting from the contract, and provides both the agency and contractor with the right to terminate the contract after 15 months of performance should certain performance thresholds not be attained.

The proposed contract provides for a "wind-up" period of unspecified length to follow either the contract's 5-year performance period or its termination by either party. The proposed contract specifies that during the wind-up period the agency will not make any surplus property available to the purchaser for purchase, and requires that the contractor submit a "closing report" to DRMS within 120 days of the contractor's determination that the sale or disposition of all remaining assets has been completed and certain accounting and bookkeeping actions have been performed.⁸

Alamo and Merchants World contend that this "proceeds sharing sale" solicitation is actually a solicitation for property disposal services, and that the solicitation is therefore flawed because it does not contain provisions of the Federal Acquisition Regulation associated with service contracts. The protesters also argue that, because of the proposed contract's proceeds sharing feature and certain other provisions, DRMS retains an ownership interest in the surplus property after its "sale" to the purchaser, and that the disposal of surplus property provisions of the Federal Property and Administrative Services Act of 1949 (FPASA), 40 U.S.C. § 484 (1994 and Supp. I 1995), and the Federal Property Management Regulations (FPMR), 41 C.F.R. Part 101-45 (1997), are therefore applicable to any resale of the surplus property by the purchaser.

In this regard, the protesters point to a number of the proposed contract's provisions which they argue are not consistent with a sales contract. The most significant aspect of the proposed contract in the protesters' view, and the one on which the protesters mainly rely for their argument that the proposed contract

⁷This figure results from the following calculation: \$60 million in gross proceeds minus \$12 million in direct costs equals \$48 million in net proceeds, 80 percent of which is \$38.4 million.

⁸The wind-up provisions described here reflect amendments made during the course of this protest.

cannot properly be considered a sales contract, is the proposed contract's requirement that the purchaser pay an amount equal to 80 percent of the net proceeds it obtains from the property to the U.S. Treasury. The protesters point out that the proposed contract includes a number of provisions authorizing the agency to review the purchaser's accounts, and question the need for such provisions if the proposed contract is actually a sales contract.

The protesters also argue that any award under the solicitation will effectively create a "partnership" or "joint venture" composed of DRMS and the successful contractor, and conclude that "[t]he foremost legal flaw in DRMS' approach is that DRMS is attempting to do by contract that which it cannot do directly, *i.e.*, circumvent applicable property disposal laws."

Neither the FPASA nor FPMR specifically defines the term "sale." *See* 40 U.S.C. § 472 (1994) and 41 C.F.R. Part 101-45. Because a "sale" is a common event, and is used in applicable statutes and regulations without a limiting definition and without legislative or regulatory history indicating a contrary result, the common and ordinary meaning of "sale" should be applied here. *Commissioner v. Brown*, 380 U.S. 563, 571 (1965). That is, "[a] sale, in the ordinary sense of the word, is a transfer of property for a fixed price in money or its equivalent"⁹ *Id.* (citation omitted). In determining whether a transaction is a sale or some other transaction, the "objective economic realities of a transaction rather than . . . the particular form the parties employed" should be considered. *Frank Lyon Co. v. United States*, 435 U.S. 561, 573 (1977).

The proposed contract will result in the transfer of property from the agency to the purchaser for a fixed price, and as such, is a sales contract. As mentioned previously, the proposed contract provides that title to the property will transfer from the government to the purchaser upon payment by the purchaser of its entire bid price for the relevant property and the removal of the property from the relevant agency installation. Specifically, the proposed contract provides:

Title to the Property shall vest in the Purchaser upon removal of the Property . . . any subsequent resale transactions are between the Purchaser and resale buyers, not between the Government and resale buyers. Any disputes or claims resulting from such transactions are between Purchaser and resale buyers, not the Government.

⁹The Uniform Commercial Code (UCC) sets forth a similar definition of the term "sale," stating that "[a] sale consists in the passing of title from the seller to the buyer for a price." UCC § 2-106(1); *see* Manheim Pattern Works, B-186837, July 30, 1976, 76-2 CPD ¶ 103 at 1-2 (our Office may refer to the UCC for guidance).

Further, under the proposed contract, the purchaser, not the government, assumes the ownership obligation of risk of loss when property is removed from the site.¹⁰ See Federal Data Corp., 60 Comp. Gen. 584, 588 (1981), 81-2 CPD ¶ 28 at 6 (risk of loss is evidence of ownership in government contracts).

The solicitation also specifies that "there are no requirements for including DRMS in any way in [the contractor's or purchaser's] operational decision-making." That is, once the purchaser pays its bid price for the property and removes it from the relevant installation, thereby obtaining title to the property in accordance with the terms of the proposed contract, the agency has no input into the manner in which the purchaser operates during the performance of the contract or during the contract's wind-up period, including its decisions regarding whether to sell or lease the surplus property, or in what manner to sell or lease the surplus property (so long as the purchase does not commit one of the enumerated prohibited activities).¹¹

Finally, the language of the proposed contract, which includes many of the standard provisions common to all DRMS sales solicitations and contracts, evidences the intent that it constitute a sales contract. The proposed contract expressly states:

Contract for Sale. This contract is an agreement for the proceeds-sharing sale of the Property by DRMS as seller to Purchaser as buyer. Contractor and DRMS expressly disavow the creation of any relationship, including without limitation principal-agent, master-servant, employer-employee, general or limited partnership, or joint venture, between DRMS and either Contractor or Purchaser.

In sum, under the proposed contract, there will be a transfer of goods from the agency to the purchaser for a price, with the purchaser obtaining title to the goods by the proposed contract's express terms; the proposed contract is thus one for sale.

Contrary to the protesters' view, the proposed contract's inclusion of the "proceeds sharing" provisions does not transform the proposed contract into something other than a sales contract. A contract for sale may provide that the seller receive payment of a certain percentage of the purchaser's net profits as consideration, or as here, partial consideration, for the property sold. In re Sitkin Smelting & Refining, Inc., 648 F.2d 252, 254 (5th Cir. 1981) (transaction where the processor of scrap materials obtained scrap from a seller and was required to process the scrap, with the purchase price for the scrap being determined by an agreed-upon formula

¹⁰The risk of loss provision was also modified during the course of the protest.

¹¹The enumerated prohibited activities include such things as sales to affiliates.

dependent upon the outcome of the processing, was a contract for sale with the processor obtaining title to the scrap upon its receipt from the seller); see Commissioner v. Celanese Corp. of America, 140 F.2d 339, 340 (D.C. Cir. 1944) (transaction where the purchaser obtained exclusive use of the seller's patent was a sale, where the purchase price for the patent was a fixed amount plus a fixed percentage of the purchaser's future profits, and the seller had the right to cancel the agreement and terminate the purchaser's rights to the patent, if within 10 years of the date of the agreement the purchaser dissolved).

The protesters contend that the amended wind-up provisions require that the purchaser sell the property and therefore show that the solicitation is actually a solicitation for property disposal services. The protesters argue that if the wind-up provisions do not require that the purchaser sell the property, they allow the purchaser "to keep property that remains unsold at wind-up . . . essentially handing the [purchaser] a 'license to steal.'" These assertions are based upon the protesters' misunderstanding of the requirements of the proposed contract's wind-up provisions. As indicated previously, the wind-up provisions simply do not require the sale or other disposition of property purchased by the purchaser during the contract's performance period. Contrary to the protesters' assertion, this does not mean that the purchaser will be allowed to keep the property after wind-up; no property will remain unsold at completion of wind-up, because wind-up is completed only after it has been determined that all property has been sold or disposed of.¹²

Also, the provisions in the contract which are designed to protect the rights of the parties under the contract, including the agency's access to the purchaser's books and records, do not alter the fundamental nature of the transaction from that of a contract for sale; such precautionary provisions do not affect the intent and purpose of the contract to vest title in the purchaser upon payment of the purchase price

¹²Although the agency has no input into the manner in which the purchaser operates during the contract's wind-up period, the agency believes that its interests in sharing in the proceeds obtained from such property and a timely wind-up will be protected by the purchaser's incentive to maximize its investment. That is, because the purchaser will continue to incur costs in maintaining and storing property remaining after the contract's performance period, and will only make money if it obtains net proceeds from the remaining property, the purchaser has economic incentives to dispose of the property promptly and in a manner that maximizes net proceeds.

and removal of the property from the agency installation.¹³ See Commissioner of Internal Revenue v. Celanese Corp., 140 F.2d at 341.

The protesters next argue that because of the proceeds sharing aspect of the proposed contract, which requires that 80 percent of the net proceeds the purchaser obtains from the purchased property be paid to the U.S. Treasury, the contract will result in the unauthorized sale of the surplus property on credit. Although the FPASA specifically authorizes the sale of surplus property on credit, 40 U.S.C. § 484(c) (1994), its implementing regulations, the FPMR, provide in relevant part that "personal property shall not be offered for sale or sold on credit without the prior approval of the Administrator of General Services or his designee."¹⁴ 41 C.F.R. § 101-45.304-9.

Neither the FPASA nor the FPMR define the phrase "sale on credit" or the term "credit." Because like the term "sale," the phrase "sale on credit" (or credit sale) refers to a common event, and is used in the FPASA and FPMR, without a limiting definition, and without legislative or regulatory history indicating a contrary result, the common and ordinary meaning of "sale on credit" should be applied here. Commissioner v. Brown, 380 U.S. at 571. In ordinary usage, "sale on credit" or "credit sale" means "[a] sale in which the buyer is permitted to pay for the goods at a later time, as contrasted with a cash sale." Black's Law Dictionary 369-370 (6th ed. 1990). A sale on credit necessarily involves the extension of credit, which in turn requires a debtor and creditor relationship. In re Ford, 14 F.2d 848, 849 (W.D. Wash., N.D. 1926).

Under the proposed contract, there is no credit extended nor debt incurred at the time of DRMS' sale of the surplus property to the purchaser because the purchaser is required to pay DRMS its full bid price for the relevant property. Although the purchaser must also pay 80 percent of the net proceeds, if any, that it obtains from the property purchased from DRMS, this payment is necessarily contingent upon the purchaser obtaining net proceeds, that is, gross proceeds exceeding the purchaser's direct costs, through, for example, the sale or lease of the property. In other words,

¹³Since the solicitation will result in a contract for the sale of surplus government property, it does not result in the creation of a "partnership" between the agency and the contractor/purchaser, as alleged by the protesters. Moreover, because we conclude that the transaction is a sale, rather than a procurement of services, we need not address the protest contentions that "if the transaction is properly considered a procurement transaction, then the contract violates at least the spirit of the statutory restrictions on fee percentages that are included in 10 U.S.C. § 2306(d)" and "the statutory prohibition against cost-plus-percentage-of-cost contracts at 10 U.S.C. § 2306(a)."

¹⁴No such approval has been granted in this case.

not only is the distribution of such net proceeds to the government dependent upon some future event, it is unclear whether any such distribution will occur, since, as explained earlier, there is no guarantee, contractual or otherwise, that net proceeds will be realized by the purchaser and thus owed to the government. Accordingly, because the concept of indebtedness requires an unconditional obligation to pay and because at the time of the sales under this contract any debt is contingent or inchoate, see C.L. Downey Co. v. Commissioner, 172 F.2d 810, 812 (8th Cir. 1949), there simply is no credit extended nor debt incurred at the time of the sale, and the sale is therefore not a sale on credit. The fact that the purchaser may become liable under the contract to pay the government further sums does not make the prior sales "on credit."

The protesters argue that the provision in the proposed contract which allow either DRMS or the contractor to terminate the contract, should certain performance thresholds not be met, "may make the contract an illusory one because neither party is legally bound to continue." The protesters explain that the proposed contract may be illusory because "the rate of return under the contract could be manipulated by the Purchaser should it determine, for whatever reason, that it wishes to get out of the contract."

The proposed contract includes specific, objective measurements to determine whether the performance thresholds are met, and expressly requires that the "Contractor and Purchaser carry out their responsibilities under the contract with honesty, good faith and fairness towards DRMS." That is, neither party can terminate the contract, should the proposed contract's performance thresholds be met or exceeded. Given that neither party can terminate the contract at will, and that the protesters' argument that the contract is illusory is predicated upon the purchaser deliberately attempting to manipulate the proceeds it obtains from the property in a manner that ensures the performance thresholds will not be met--conduct which under the terms of the contract places the purchaser in material breach--we fail to see why the proposed contract can properly be considered illusory.

The protesters argue that "[t]he solicitation violates the antitrust approval requirements set forth in the [FPMR]." The FPASA, 40 U.S.C. § 488 (1994) and the FPMR, 41 C.F.R. § 101-45.310, require that the Attorney General of the United States be notified whenever an award is proposed to be made to any private interest of personal property with an estimated fair market value of \$3,000,000 or more. In this regard, the FPMR requires that the agency provide the Attorney General with considerable information regarding both the property to be sold and the proposed purchaser, including, for example, the proposed purchaser's name, address, trade name, sales volume as of the latest fiscal or calendar year, and nature of business. 41 C.F.R. § 101-45.310. There is no requirement in the applicable statute or regulation that a solicitation for the sale of surplus property expressly inform bidders that the terms of the sale, including the identity of the proposed awardee,

may be referred to the Attorney General. Moreover, as pointed out by the agency, the record reflects that DRMS advised bidders regarding the applicability of antitrust laws to this sale.¹⁵ As such, we see no basis to find that the solicitation violates either 40 U.S.C. § 488 or 41 C.F.R. § 101-45.310.

The protesters contend that the sheer size of the contract in terms of dollar amount and length of contract as well as the requirements for up-front financial commitments, that is, the submission of a \$100,000 bid bond, a \$400,000 payment bond, and access to a \$3 million line of credit, unduly restrict competition because prospective bidders, such as the protesters, may not be able to perform a contract of this size or comply with the required financial commitments.

The FPASA provides that solicitations for the disposal of property be "on such terms and conditions as shall permit that full and free competition which is consistent with the value and nature of the property involved." 40 U.S.C. § 484(e)(2)(A) (1994); see William D. Garrett, B-192592, Nov. 16, 1978, 78-2 CPD ¶ 350 at 2. The determination of the agency's needs in this regard and the best method of accommodating them are primarily within the agency's discretion and, therefore, we will not question such a determination unless the record clearly shows that it was without a reasonable basis. Resource Recovery Int'l Group, Inc., B-265880, Dec. 19, 1995, 95-2 CPD ¶ 277 at 3.

The agency contends that this pilot solicitation is intended to allow DRMS to get out of the business of conducting local and national sales by combining certain categories of surplus property into proceeds sharing term sales. Such sales are designed to enhance DRMS' rate of return by enlisting the marketing abilities of the private sector. This is necessary because DRMS is scheduled to have its work force drastically reduced, and the previous methods of disposing of surplus property had not been profitable overall to the government.

DRMS adds that the size, scope, and term of this contract are "designed to attract the best bidders and to achieve the greatest cost efficiencies and revenue enhancements possible." The agency states that because the successful purchaser will be required to pay for and remove considerable amounts of surplus property from the relevant government installations shortly after contract award, and the immediate generation of revenues from these properties by the purchaser is unlikely, it determined that requiring the purchaser to have access to a \$3 million

¹⁵Amendment No. 2 to the solicitation, which among other things sets forth certain questions and answers, includes the following:

[Question] 85. Is the contract exempt from the Sherman Anti-Trust Act?

ANSWER: No.

line of credit was reasonable to ensure that the purchaser was able to adequately finance its initial costs. The agency also points out that the \$500,000 payment deposit (comprised of the initial \$100,000 bid deposit and additional \$400,000 required after award) is relatively small in light of the agency's estimate that the surplus property that will be made available to the contractor during each year of the contract will have a market value of \$30 million.

Given the apparent reasonableness of the agency's explanation, and the protesters' failure to substantively respond to it, we have no basis to determine that the financial requirements imposed by the solicitation or the size, scope, or length of the contract contemplated by the solicitation are unreasonable. Resource Recovery Int'l Group, Inc., *supra*; see Aalco Forwarding, Inc., et al., B-277242.12, B-277241.13, Dec. 29, 1997, 97-2 CPD ¶ __ at 6-8.

The protesters finally question the propriety of the "two-step approach" set forth in the solicitation. Our Bid Protest Regulations require that protests based upon improprieties apparent from the face of the solicitation be filed prior to its closing date. 4 C.F.R. § 21.2(a)(1) (1997). Where a protester supplements its protest with new and independent allegations, those allegations must independently satisfy our timeliness requirements; our Bid Protest Regulations do not contemplate the unwarranted piecemeal presentation of protest issues. PCB Piezotronics, Inc., B-254046, Nov. 17, 1993, 93-2 CPD ¶ 286 at 4-5. The protesters' challenge to the agency's use of a "two-step" solicitation approach is untimely and will not be considered because it was raised for the first time in the protesters' comments on the agency report, which were filed with our Office on November 17, approximately 7 weeks after the solicitation's September 30 closing date.

The protest is denied.

Comptroller General
of the United States