



**Comptroller General  
of the United States**

Washington, D.C. 20548

# Decision

## DOCUMENT FOR PUBLIC RELEASE

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**Matter of:** Tidewater Construction Corporation

**File:** B-278360

**Date:** January 20, 1998

Daniel R. Weckstein, Esq., and Howard W. Roth, III, Esq., Vandeventer, Black, Meredith & Martin, L.L.P., for the protester.

Harold I. Rosen, Esq., and Mark E. Davis, Esq., Seltzer and Rosen, for Pizzagalli Construction Company, an intervenor.

George N. Brezna, Esq., and Vicki O'Keefe, Esq., Department of the Navy, for the agency.

Charles W. Morrow, Esq., and James A. Spangenberg, Esq., Office of the General Counsel, GAO, participated in the preparation of the decision.

## DIGEST

Agency failed to perform a proper cost realism analysis in evaluating for the award of a cost-plus-award-fee construction contract where its only analysis of the offerors' proposals was a comparison of the proposed costs for various work items to the government estimate, and there was no analysis of the cost elements of the proposed costs or consideration of possible differences in technical approach between the proposals and the government estimate.

## DECISION

Tidewater Construction Corporation protests the award of a contract to Pizzagalli Construction Company under request for proposals (RFP) No. N62470-96-R-6134, issued by the Naval Facilities Engineering Command, for the construction of a crane rail interconnect system at the Norfolk Naval Shipyard, Portsmouth, Virginia. Tidewater objects to the Navy's cost realism evaluation and best value analysis that resulted in Pizzagalli's lower-rated, lower-cost proposal being selected for the award.

We sustain the protest.

The RFP, issued on April 22, 1997, contemplated the award of a cost-plus-award-fee contract for the construction of an interconnecting crane rail system on certain piers, including relocation of railroad tracks and utilities, paving, and related site work. The RFP, as amended, broke down the basic work into 13 work items. Offerors were required to propose a "target cost" for each of the 13 items, and a

proposed award fee for the first work item, the second work item, and the combination of the other 11 work items. The RFP, as amended, also contained four priced options. Options 1 and 2 required the construction of a crane rail between certain piers. Option 3 required the construction of an oily waste/waste oil collection system. Options 4 and 5 required the construction of crane rail spurs at certain piers. Target costs and award fees were requested for each option. In addition, option 1 was broken down into 2 work items and option 3 was broken down into 7 work items.

The RFP evaluation scheme provided for award on a best-value basis in which the technical area was said to be more important than cost. At the time the RFP was issued, proposals were to be based upon a 60-percent design of the project. Proposals were to be evaluated for "technical and contractual acceptability, and for cost reasonableness." The technical evaluation factors, listed in descending order of importance, were as follows:

1. Prime Contractor's Past Performance
2. Prime Contractor's Corporate Experience
3. Major Subcontractor's Corporate Experience and Performance
4. Work Plan/Schedule/Contractor Quality/Safety
5. Support for Small Business, Small Disadvantaged, And Women Owned Small Business Program

The RFP did not request detailed cost information, but advised that back-up documentation to support proposed costs for various large elements of cost and elements of cost making up the offeror's overhead pool would be requested during discussions. Subsequent amendments requested offerors to identify the home office overhead rate, and the elements of cost thereof, and advised that overhead should be included in all prices and that overhead would be reimbursed at the actual incurred rate determined by yearly Defense Contract Audit Agency (DCAA) audits. During discussions, the offerors were requested to identify cost items under the first work item of the basic contract that exceeded \$400,000.<sup>1</sup> No other information regarding the offerors' elements of their proposed costs was requested. To assist in the cost evaluation, the Navy had an architect/engineer prepare cost estimates tracking 35 percent, 60 percent, and 100 percent design of the project.

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<sup>1</sup>This information was requested because the agency was concerned that the offerors' proposed costs for the basic contract work exceeded available funding. In discussions, the agency explored with the offerors possible design changes to address these concerns. According to the agency, some changes that reduced cost were incorporated into the RFP.

On May 22, the Navy received proposals from Tidewater, Pizzagalli, [DELETED]. All were included in the competitive range. After discussions, offerors submitted revised technical and cost proposals incorporating various amendments, including the 100-percent design of the project. After further discussions, best and final offers (BAFO) were submitted on September 8.

Tidewater's BAFO proposed a total target cost plus fee of [DELETED] and Pizzagalli's BAFO proposed a total target cost plus fee of [DELETED].<sup>2</sup> The architect/engineer's estimate based on the 100-percent design was [DELETED]. This estimate was the basis for the agency's cost realism and reasonableness evaluation. Hearing Transcript (Tr.) at 14-17, 36-39, 50, 61.<sup>3</sup> The Navy's cost realism evaluation consisted solely of comparing each offeror's target cost under work items to the government estimate for each of these items. Tr. at 14-17. Based on this evaluation, no probable cost adjustments were made to the proposed costs, and the Navy determined each offeror's price to be fair and reasonable. The Navy specifically noted that Pizzagalli's proposed target cost plus fee "compared favorably" to the government estimate, in which the government had a high level of confidence.

Tidewater's BAFO technical proposal was [DELETED] rated with a [DELETED] rating, and Pizzagalli's BAFO received an "[DELETED]" rating.<sup>4</sup> Tidewater's [DELETED]. However, the SSA found [DELETED].<sup>5</sup> The Navy awarded the contract to Pizzagalli on September 26. This protest from Tidewater followed. Contract performance has been stayed pending our decision in the matter.

Tidewater contends that the Navy's evaluation of cost realism, particularly regarding Pizzagalli's low cost proposal, which consisted of merely a comparison of each offeror's proposed target cost plus fee to the government estimate, did not constitute a proper cost realism analysis. Tidewater also argues that the government estimate was defective and could not serve as a proper basis to evaluate cost realism, as is indicated by the fact that the two more experienced and higher-rated offerors proposed costs more than [DELETED] the government

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<sup>2</sup>The [DELETED] target cost plus fee was [DELETED].

<sup>3</sup>A hearing was conducted to elicit testimony regarding the government estimate, cost evaluation, and best-value analysis from the source selection authority (SSA) and an architect/engineer representative responsible for preparing the government estimate.

<sup>4</sup>The [DELETED] technical proposal received [DELETED]. The possible ratings were unacceptable, [DELETED].

<sup>5</sup>Similarly, the agency found [DELETED].

estimate.

When an agency evaluates proposals for the award of a cost reimbursement contract, an offeror's proposed estimated cost of contract performance and proposed fees should not be considered controlling since, regardless of the costs proposed by an offeror, the government is bound to pay the contractor its actual and allowable costs. United Int'l Eng'g, Inc. et al., 71 Comp. Gen. 177, 185 (1992), 92-1 CPD ¶ 122 at 10. Consequently, the agency must perform a cost realism analysis to determine the realism of the offeror's proposed costs and to determine what the costs are likely to be under the offeror's technical approach, assuming reasonable economy and efficiency. AT&T Corp., Advanced Technology Sys., B-261154.4, Oct. 16, 1995, 96-1 CPD ¶ 232 at 8. Defense Federal Acquisition Regulation Supplement sections 215.801 and 215.805-70 require that whenever a cost reimbursement contract is anticipated, a cost realism analysis be performed of the overall costs in an offeror's proposal to determine if they (1) are realistic for the work to be performed, (2) reflect a clear understanding of the requirements, and (3) are consistent with the various elements of the offeror's technical proposal. Our review of an agency's cost evaluation is limited to a determination of whether the evaluation was reasonably based and was not arbitrary. The Jonathan Corp., Metro Mach. Corp., B-251698.3, B-251698.4, May 17, 1993, 93-2 CPD ¶ 174 at 10.

The SSA testified that the cost realism analysis of Pizzagalli's and the other offerors' costs consisted solely of a comparison of the bottom line target cost plus fee for the 40 work items making up the basic contract and option work to the government estimate for these items.<sup>6</sup> Tr. at 14-16, 49-50, 61, 112. The SSA stated that the Navy did not attempt to independently verify whether Pizzagalli's or the other offerors' target costs plus fees were realistic in light of their individual technical approaches. See Tr. at 36-38. Further, the SSA testified that the agency did not make any attempt to analyze the differences in the offeror's technical approaches to determine if the cost differences resulted from their technical approaches or some other factors. Tr. at 38-39. The SSA also testified, and the record confirms, that no information was requested to evaluate the cost elements of the cost proposals, and DCAA was not asked to review cost proposals because this would be too time consuming. See Tr. at 65-69. Indeed, the SSA stated that no attempt was made to calculate an evaluated probable cost for Pizzagalli, or the other offerors, except to confirm their proposed target costs. Tr. at 49-52.

We find that the Navy's reliance solely upon a comparison of Pizzagalli's and the other offerors' target costs to the government estimate as the basis for determining cost realism and reasonableness was improper. To determine cost realism, an

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<sup>6</sup>We note that there were actually only 24 separate work items for which offerors proposed costs. The other 16 items that were compared were for award fee or for totals of separate work items and award fees.

agency must perform a cost analysis in accordance with Federal Acquisition Regulation (FAR) sections 15.801 and 15.805-3 (June 1997). Specifically, FAR § 15.801 defines cost analysis to mean:

the review and evaluation of the separate cost elements and proposed profit of--(a) an offeror's . . . cost or pricing data or information other than cost or pricing data; and (b) the judgmental factors applied in projecting from the data to the estimated costs in order to form an opinion on the degree to which the proposed costs represent what the cost of the contract should be, assuming reasonable economy and efficiency.

While the agency in its report argues that it performed a cost realism analysis "consistent with the techniques suggested by FAR § 15.805-3," the agency could not have done so because it did not require offerors to provide or identify elements of cost and did not in any case analyze such costs in determining cost realism.<sup>7</sup> Tr. at 38, 67-68. Rather, the record establishes that the agency's evaluation was a "price analysis" that is only intended to "ensure a fair and reasonable price," and is not intended to be used, nor can it reasonably be used, to ascertain the cost realism of a cost reimbursement proposal. See FAR § 15.805-2; see KPMG Peat Marwick, L.L.P., B-259479.2, May 9, 1995, 95-2 CPD ¶ 13 at 7-10. This is so because the government will be liable to reimburse the contractor its actual costs (within certain limits), not the offeror's proposed costs, such that the government should determine what the contract should cost, assuming reasonable economy and efficiency. The Jonathan Corp., Metro Mach. Corp., *supra*, at 10.

The Navy's comparison of the various work item costs in the government estimate to the offerors' target costs for the same line items cannot suffice as a sufficient analysis of cost realism where the agency has not considered the offerors' individual technical approaches or determined whether the offerors' proposals are consistent with the technical and cost parameters that were reflected in the government estimate. See ManTech Envtl. Tech., Inc., B-271002 et al., June 3, 1996,

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<sup>7</sup>While the agency did request and obtain certain elements of cost during discussions, these constituted a relatively small percentage of the contract value and they were not used in the cost realism analysis. For example, while the agency requested and obtained the costs of items exceeding \$400,000 for the first of the 24 work items, this was in the context of ascertaining why proposals exceeded the government funding for this work item. Tr. at 15-16. The agency does not state how this was used to determine the cost realism of the BAFOs, and the contemporaneous documentation does not evidence that it was considered in the cost realism analysis of the BAFOs. With regard to the overhead rates and the elements thereof, the SSA testified that this information was not evaluated in determining cost realism. Tr. at 67-68.

96-1 CPD ¶ 272 at 4-5, 8-12; The Jonathan Corp., Metro Mach. Corp., supra, at 11-13. As indicated above, the agency made no attempt to determine the offerors' technical approaches. Tr. 36-39.

Further, the efficacy of the agency's cost realism analysis is also put into question by the fact that the Navy did not make any adjustments or question Pizzagalli's or the other offerors' costs for the work items, even where the proposed target costs were significantly different from those reflected in the government estimate, and provided no explanation for its failure to do so, except to point out that the bottom line of Pizzagalli's proposed target costs was close to the bottom line of the government estimate.<sup>8</sup> Tr. at 49-52, 57-61. Moreover, while the SSA testified that it did not undertake any more steps to evaluate cost realism because of his high confidence in the government estimate, Tr. at 16-17, 19, the individual who prepared the estimate admitted at the hearing that the estimate contained various errors and understated costs.<sup>9</sup> Tr. 118-119, 128-129, 132-133.

In sum, we find that the Navy did not perform a reasonable evaluation of cost realism, and we sustain the protest on this basis.

We recommend that the Navy obtain cost data sufficient to perform a cost realism analysis, and make a new source selection.<sup>10</sup> We also recommend that the protester be reimbursed the reasonable costs of filing and pursuing the protest, including attorneys' fees. 4 C.F.R. § 21.8(d)(1) (1997). The protester should submit its

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<sup>8</sup>For example, for Option 2, the government estimate is approximately [DELETED] whereas Pizzagalli's proposal was approximately [DELETED]. Tr. at 60.

<sup>9</sup>The preparer of the estimate testified at the hearing that the estimate would not have changed notwithstanding the various errors. Tr. 185-186. However, the preparer also testified that he did not do a thorough re-analysis of the estimate in response to the protest, Tr. 137, and initially in an affidavit the preparer argued that some of the same errors that it now admits are errors were not committed. In light of our recommendation, we expect that the agency will thoroughly review the estimate.

<sup>10</sup>The agency acknowledges certain technical scoring errors that the protester states were not properly accounted for in the award selection. The agency should give appropriate consideration to these matters in making its new award selection.

certified claim for such costs, detailing the time expended and the costs incurred, directly to the contracting agency within 60 days after receipt of this decision.

The protest is sustained.

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of the United States