U.S. ENVIRONMENTAL PROTECTION AGENCY

OFFICE OF INSPECTOR GENERAL

Materials Relating to Resolution of Evaluation Report No. 13-P-0209 Concerning Agency's $1.5 Million Payment to a Contractor

June 9, 2014

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UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

APR 10 2014

THE INSPECTOR GENERAL

MEMORANDUM

SUBJECT: Resolution of Office of Inspector General Report No. 13-P-0209, *Opportunities for EPA-Wide Improvements Identified During Review of a Regional Time and Materials Contract*, Issued April 4, 2013

FROM: Arthur A. Elkins Jr.

TO: Robert Perciasepe, Deputy Administrator

In the above-referenced report, the Office of Inspector General (OIG) determined that the U.S. Environmental Protection Agency (EPA) improperly paid a contractor approximately $1.5 million, and recommended that the EPA modify the contract and recover the payment. The agency has not concurred with that recommendation. As provided by EPA Manual 2750, OIG representatives met with the acting Chief Financial Officer and agency representatives on March 12, 2014, in an effort to resolve the dispute. That meeting, and a subsequent meeting of OIG and EPA Office of General Counsel attorneys, did not result in resolution. The EPA Manual 2750 dispute resolution process provides that this matter should now come to you to make a final determination on behalf of the agency as to whether to accept or reject the OIG recommendation.

In this memorandum, the OIG summarizes the legal positions taken by the OIG and the agency during the course of the EPA Manual 2750 dispute resolution, and frames the matters now before you for determination of the final agency position. The two Office of General Counsel legal memorandums and three OIG legal memorandums that were prepared in connection with this dispute resolution are attached at Attachments A through E and will assist you in your analysis.

The factual background for the OIG evaluation report issue that is in dispute can be simply stated. The EPA awarded a remedial action contract to CH2M Hill on September 24, 2008. The contractor agreed to provide architect/engineer, technical and management services to the EPA for its project. The remedial action contract included a time and materials (T&M) pricing arrangement. Under the contract, the agency agreed to pay the contractor a 4 percent profit for work performed by a group of subcontractors. That profit totaled $1,524,196.44 (that figure, as of April 27, 2012, is presumably higher now).

OIG Legal Position

The OIG legal position is based on the Federal Acquisition Regulation (FAR), to which the EPA is subject. The FAR at Subsection 32.111(a)(7) states that the FAR clause at Section 52.232-7 "shall" be inserted "when a time-and-materials or labor-hour contract is contemplated." *See* Attachments B, D and E. The clause states that "the Government will not pay profit or fee to the

prime Contractor on materials." *Id.* FAR Subsection 16.601(a) defines "materials," among other things, as "[s]ubcontracts for supplies and incidental services for which there is not a labor category specified in the contract." *Id.*

The remedial action contract referenced here is a T&M contract. However, the agency, for reasons that it has not persuasively explained to the OIG, did not include the requisite FAR clause that forbade payment of profit to a prime contractor for materials. Instead, the agency, in contravention of the clause, paid profit to the prime contractor for work by a group of subcontractors. (The subcontracting work fit the FAR definition of "materials" because it was described in the contract as precisely the same types of work that are listed in the FAR as "incidental services" in an architect/engineering contract, and the services were not charged consistent with labor rates set out in the contract. *See* Attachment E.) In short, the agency overpaid the contractor and violated the FAR because it chose to pay profit on certain subcontracting work in a T&M contract. Therefore, the OIG has recommended that the agency revise the contract and recover the $1,524,196.44 (plus) in overpayment.

Agency Legal Positions and OIG Responses

In response to the OIG's recommendation and legal position, the agency has forwarded a series of legal arguments over time. Because there was no apparent resolution of any of the arguments, all of the positions and OIG responses are summarized here.

First, the agency argued that EPA did include in the remedial action contract an agency EPA Acquisition Regulation (EPAAR) procurement clause that was similar to (and therefore an allowable substitute for) the missing FAR clause. The agency asserted that, because the EPAAR clause did not include the prohibition on profit, there was no procurement violation. *See* Attachments A and C. However, the FAR at Subsection 1.304(b)(2) specifies that an agency acquisition clause, except as required by law or when a deviation is authorized, "shall not" conflict with or be inconsistent with the FAR. *See* Attachments B and D. The EPAAR clause, because of the obvious conflict with the similar FAR clause, cannot control. The agency has asserted, without evidence, that it obtained a deviation from the FAR clause. *See* Attachment C. That assertion makes no sense. The purpose of the FAR clause prohibition is to ensure that the government does not pay double profit in a T&M contract; so, why would a deviation be justified given that it might lead to the possibility that EPA would pay double profit (as it did in the remedial action contract)? *See* Attachments B and D. In all likelihood, the 1984 EPAAR clause was simply not updated to reflect the 2007 FAR clause and its prohibition. As such, the agency cannot now invoke its own clause as a substitute for the legally required FAR clause.

Second, the agency asserted that the missing FAR clause was not required in the contract. *See* Attachment E, Attachment 1. However, the agency has not provided legal support for this position, nor has it ever provided an adequate reason for why it failed to include a key clause that was clearly required by law.

Third, the agency argued that even if it had included the FAR clause (which was required by law) in the remedial action contract, the clause would not have been applicable to the facts of the contract. *See* Attachments C and E, Attachment 1. In Attachment E, Attachment 1, the agency

most recently asserted, without support, that the subcontracting services for which a profit was paid did not correspond to the FAR definition of "materials" ("[s]ubcontracts for supplies and services for which there is not a labor category specified in the contract") because the subcontracted "construction services" did not fit the FAR definition of incidental services and there were labor categories for the subcontracting work. *Id.* However, the facts show just the opposite. The remedial action contract language evidences that the services rendered by the subcontractors (for which a profit was paid) fit almost perfectly the agency-recommended FAR definition of "incidental services" in an architect/engineering contract. *See* Attachment E. Also, there is no evidence in the remedial action contract that the subcontracting work was charged consistent with the contract's labor categories; to the contrary, contractual language and invoices show that the subcontracting work was categorized as "Non-Labor." *See* Attachment E, especially Attachment 3. Thus, the agency assertion that the "legal" precepts do not apply because the "facts" dictate differently fails; the evidence demonstrates this to be exactly a circumstance where the missing FAR clause was required and applicable to a government contract.

Fourth, the agency argued that the "profit" paid by the government to the prime contractor for services by a group of subcontractors really was a "premium" and therefore it did not violate the missing FAR clause. Factual evidence demonstrates that this is a purely semantic distinction. The contract referred to the payment as "profit"; the invoices referred to the payment as "profit"; and the contractor, based on interviews, perceived the payment to be "profit." *See* Attachments B and D. Further, and perhaps most importantly, the payment functioned as a "profit." *Id.*

Fifth, the agency contends that even if it accepted the OIG's legal position that the FAR required the missing clause, the agency would not be able to act. The agency asserted that a failure to include a legally required clause renders the agency legally unable to demand repayment from the prime contractor because the contractor did not enter into a contract that included the prohibitive FAR clause. *See* Attachments A and C. To begin, the agency has refused to request repayment of the wrongfully paid profit, and so it does not know whether a contractor that charged approximately $102 million for a government contract would voluntarily return the $1,524,196.44 (plus) overpayment that occurred due to the government's error. Indeed, federal case law has stated that contractors are presumed to have constructive knowledge of federal procurement regulations and so this contractor cannot claim surprise if asked to return money that should not have been paid to it because of absence of a requisite FAR clause. *See* Attachment D, page 3. As such, the agency is not prevented, legally or otherwise, from requesting that the contractor voluntarily repay the profit because of the agency's error. If the agency were to request repayment and the contractor refused, the agency has available to it as a litigation guide (should it decide to litigate) case law where the government successfully recovered money under circumstances similar to those here. In the *Christian* case and the federal cases that followed it (*see* Attachments B and D), federal courts have held that the government should not suffer negative consequences arising from failure to insert critical clauses; those courts read the clauses back into federal contracts as a matter of law and required repayment from contractors. *Id.* Nothing precludes the agency from requesting voluntary repayment, and if it decides to litigate the agency can turn to the "Christian Doctrine" for legal support.

In sum, the agency has not presented any legal or factual basis for the OIG to simply ignore what the OIG found during the course of this program evaluation regarding the missing FAR clause and the applicability of the clause to the remedial action contract. The OIG has no authority to compromise a debt owed to the United States. Therefore, the OIG recommends, on behalf of United States taxpayers, that EPA modify the contract and request return of an overpayment amounting to at least $1,524,196.44.

If you have any questions regarding this memorandum, please contact Carolyn Copper, assistant inspector general for the Office of Program Evaluation, at (202) 566-0829 or (Copper.Carolyn@epa.gov); or Eric Lewis, product line director, at (202) 566-2664 (Lewis.Eric@epa.gov).

Attachments (5)

cc: Avi Garbo, General Counsel, Office of General Counsel
Kenneth Redden, Associate General Counsel, Civil Rights and Finance Law Office, Office of General Counsel
Maryann Froehlich, Acting Chief Financial Officer, Office of the Chief Financial Officer
Craig Hooks, Assistant Administrator, Office of Administration and Resources Management
John R. Bashista, Director, Office of Acquisition Management
Jared Blumenfeld, Regional Administrator, Region 9
Kathy O'Brien, Director, Office of Planning, Analysis, and Accountability, Office of the Chief Financial Officer
Amir Ingram, Special Assistant, Office of the Deputy Administrator

Attachment A

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

OFFICE OF
GENERAL COUNSEL

MEMORANDUM

To: John Bashista, Director, Office of Acquisition Management

From: Jonathan S. Baker, Office of General Counsel

Re: OIG Audit OPE-FY12-0008 – Possible Recovery of Costs

Date: June 21, 2013

You have asked for our opinion on possible bases for a Government claim to recover funds paid to the prime contractor, CH2M Hill, Inc. (Hill) under Contract No. EPS-9-0804 – Region 9's remedial action contract (the RAC contract or Contract). As discussed below, under the facts as we understand them, we cannot identify a basis under which to pursue recovery of costs as suggested by the Office of Inspector General (OIG)'s recommendation in audit number OPE-FY12-0008 (the OIG audit).

Background

EPA Region 9 awarded the RAC contract to Hill on September 24, 2008. Under the contract, Hill provides professional architect and engineering (A&E) services, technical, and management services to EPA to support activities under the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA). The base period was 3 years with award terms for up to an additional 7 years. EPA exercised the first award term, extending performance to September 23, 2013. The contract is a fixed-rate indefinite delivery/indefinite quantity (ID/IQ) vehicle with a ceiling of $116,250,000.

The contract was procured under FAR Part 36 Brooks Act procedures. Under the Brooks Act, EPA first performed a technical evaluation of the offerors and ranked them. At that point, cost negotiations commenced with the most highly ranked firm -- Hill. In addition to providing A&E services, the statement of work includes prime contractor oversight and management of construction projects, and requires the prime contractor to subcontract all construction work on a competitive basis. During cost negotiations, Hill demonstrated that the market for A&E services and construction management/oversight are different – namely, that construction management/oversight is riskier and that such additional risk needs to be reflected in the contract's cost structure. Rather than capture that additional risk through a higher fixed rate for every hour that Hill performed under the contract, the Contracting Officer negotiated a four (4) percent "premium" to be paid to Hill only in performing construction management/oversight. While this premium rate structure could have been reflected by creating two separate fixed rates in the contract – one for A&E work and one for construction

management/oversight – this premium rate for construction management/oversight was captured by adding a 4 percent premium (labeled as "profit") applicable to construction subcontracts only. [1]

Hill has been performing the contract since the September 24, 2008 award date. Hill has billed and EPA has paid over $1.5 million under the subcontract management/oversight premium. In its audit report, the OIG has questioned this premium payment to Hill and has recommended that EPA pursue recovery of these funds from Hill.

Discussion

In order to pursue recovery of funds from a contractor, EPA must have a basis to do so. Broadly stated, possible bases would be: (1) the payment is prohibited by law and/or is an unallowable cost under FAR Parts 31 and 32; (2) performance-based issues (such as breach of contract, excess reprocurement costs, defective performance costs, recovery for payments made on undelivered goods or services); or (3) recovery of overpayments provisionally paid to the contractor. *See Cibinic & Nash, Administration of Government Contracts (3rd ed. 1995) pp. 1277-1280.* We do not believe any of these bases are applicable here.

In the first place, we do not believe that this 4 percent premium (labeled as "profit") is prohibited by law or is otherwise unallowable. While it would have been clearer to have established two separate rates under the contract for A&E work and for construction management/oversight, the purpose of the premium was to compensate Hill for the additional risk specifically associated with construction management/oversight without spreading that risk over every hour performed on both A&E work and construction management/oversight by generally increasing the contract's fixed rates. Moreover, the premium does not constitute a prohibited cost plus a percentage of cost arrangement. *See* 41 U.S.C. § 254(b); *Muscany v. United States,* 324 U.S. 49, 61-62 (1944). A cost plus percentage of cost situation arises when an element of cost is paid as a percentage of cost on a cost element that can increase during performance. Here, while the premium was stated as a percentage of subcontract costs, the contract required Hill to compete construction subcontracts, which resulted in fixed-price or firm fixed-rate subcontracts. As a result, the subcontracts costs could not increase during performance; therefore, the premium paid to Hill was a fixed sum that could not increase as the subcontracts were performed. Accordingly, it does not fall within the cost plus percentage of cost prohibition.

Furthermore, while the OIG contends that FAR 52.232-7 prohibits the payment of profit on subcontracts, that clause was not included in the contract and does not appear to be the type of mandatory procurement clause that should be read into this contract as a matter of law. *See G.L.Christian & Associates v. United States,* 161 Ct. Cl. 1, 312 F.2d 418, 160 Ct. Cl. 58, 320 F.2d 345, *cert. denied,* 375 U.S. 954 (1963), 170 Ct. Cl. 902, *cert. denied,* 382 U.S. 821 (1965). In contrast, the Hill contract contains EPAAR 1552.232-73, Payments – Fixed Rate contract, which does not prohibit the payment of this premium on subcontracts. In addition, we have found no other cost principle that categorizes this payment as an unallowable cost.

[1] As stated in OARM's January 24, 2013 response to the audit, Region 9 has committed to including a comprehensive set of rates in future contracts that segregates those functions associated with A&E work from those associated with construction oversight services. In addition, OAM surveyed other similar headquarters and regional contracts and determined that the pricing method at issue here was unique to this one Region 9 RAC contract.

Another basis for recovery of costs paid to a contractor would arise from the contractor's performance, including breach of contract or failure to perform/deliver some or all of the construction management/oversight work for which it had been paid by EPA. There is nothing to suggest that Hill breached the contract or otherwise did not perform/deliver the construction management/oversight work at issue here.

Finally, as a result of finalizing indirect cost rates during contract closeout, an agency could pursue recovery of overpayment of costs provisionally paid to a contractor during performance. This situation would arise under cost-reimbursement contracts that utilize provisional indirect billing rates. Because the Hill contract is not a cost-reimbursement instrument, this basis for cost recovery does not apply.

Conclusion

Based on our understanding of the facts of this contracting issue, we cannot identify a basis under which to seek repayment of the construction management/oversight premium agreed to by Hill and EPA under its RAC contract. If you would like to discuss this matter further, please let me know.

cc: Ken Pakula, OGC

Attachment B

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON D C 20460

September 3, 2013

MEMORANDUM

OFFICE OF
INSPECTOR GENERAL

SUBJECT: Resolution of Office of Inspector General Report No. 13-P-0209, Opportunities for EPA-Wide Improvements Identified During Review of a Regional Time and Materials Contract, April 4, 2013

FROM: Steven M. Alderton, Senior Associate Counsel

TO: Carolyn Copper, Assistant Inspector General
Office of Program Evaluation

You requested that the OIG Office of Counsel respond to an EPA Office of General Counsel legal memorandum, dated June 21, 2013, addressing recovery of funds paid to an EPA contractor. The legal question is whether a Federal Acquisition Regulation clause that prohibits the additional payment of a profit in a time and materials contract is applicable to an EPA contract with CH2M Hill, Inc. OGC took the position that the FAR clause is not applicable because it was omitted from the contract. We conclude that the clause is still applicable and that the EPA violated the FAR when it agreed to pay additional profit to CH2M Hill.

Background

The remedial action contract in question (EPS90804) was awarded by EPA to CH2M Hill on September 24, 2008. The contractor agreed to provide architect/engineer, technical and management services to the EPA to support activities under the Comprehensive Environmental Response, Compensation and Liability Act of 1980. The base performance period was for 3 years, with options for up to 7 additional years.

The CH2M Hill contract provides for a fixed rate indefinite delivery/indefinite quantity with time and materials pricing. The government orders work through task orders, including fixed rate time and materials type task orders. The time and materials task orders are used to acquire services based on direct labor hours, at specified fixed hourly rates, and actual cost for materials. The fixed hourly rate included wages, overhead, general and administrative expenses, profit, and the actual cost of materials (with certain exceptions not relevant here).

In addition to the fixed hourly rate (which includes the profit to which the contractor is entitled) discussed above, EPA agreed to a 4 percent payment on subcontracts. The contract referred to the payment as a "profit." The OGC legal memorandum referred to the additional payment as a "premium" that was necessary to compensate the prime contractor for the additional risk associated with the construction management/oversight. OGC seemed to suggest that the use of the label "profit" in the contract was a misleading error, and that it would have been more accurate to have called it a

"premium." However, the contractor reported to the EPA acquisition manager that it considered the extra payment to be profit; the contractor also referred to the payment as a "fee." Further, while negotiating this item, the EPA acquisition manager used EPA Acquisition Regulation Subsection 1515.404-471 – the EPA structured approach for developing profit or fee objectives. Regardless of what it is termed, the 4 percent payment clearly constituted an additional government payment to the prime contractor on top of the already negotiated fixed rate, which included the contractor's profit. The nomenclature is irrelevant.

Legal Position

We conclude that the additional 4 percent payment to CH2M Hill on subcontracts is prohibited by the FAR. FAR Subsection 32.111(a)(7) states that the FAR clause at 52.232-7 "shall" be inserted "when a time-and-materials or labor-hour contract is contemplated." EPA failed to include the clause. FAR Subsection 52.232-7(b)(7), which was required by federal regulation to have been inserted into the contract, states that, except for a few exceptions not relevant here, "the Government will not pay profit or fee to the prime Contractor on materials." FAR Subsection 16.601(a) defines "materials" as including subcontracts. Hence, EPA's payment to CH2M Hill of 4 percent of the amount charged for work performed by subcontractors was in violation of the FAR.

The consequence of EPA's failure to include and then act in accordance with the requisite FAR clause regarding profit on materials (again, defined as including subcontracts) is significant. Through April 27, 2012, CH2M Hill billed the agency the cumulative amount of $38,104,278.36 for subcontracts – plus a total of $1,524,196.44 for the 4 percent profit/fee. That latter amount was not allowable and should not have been paid under the law.

OGC presents two bases for allowing the additional payments. First, OGC noted that the CH2M Hill contract did not include the FAR clause referenced above, so the clause does not apply here. That is, even though it is the law of the land, the EPA was not bound by it because it was omitted from the contract. OGC cited to the Christian Doctrine and argued that this is not the sort of clause that must be read into the contract as a matter of law. In *G.L. Christian & Associates v. United States*, 312 F.2d 418, *reh'g denied*, 320 F.2d 345, *cert. denied*, 375 U.S. 954 (1963), the Court of Claims established what has come to be known as the Christian Doctrine. In *Christian*, the government terminated a construction contract for convenience – even though the contract did not include the termination clause (312 F.2d at 424). The contractor sued for breach of contract. The court denied the claim, concluding that the termination clause was required by applicable federal procurement regulations and therefore incorporated the missing termination for convenience clause (*Id.* at 424, 427).

Generally, the Christian Doctrine holds that a court may insert a clause into a government contract as a matter of law if that clause is required by relevant federal regulations. However, as the court noted in *General Engineering & Machine Works v. O'Keefe*, 991 F.2d 775 (Fed.Cir.1993), the Christian Doctrine "does not permit the automatic incorporation of every required contract clause" (*Id.* at 779). Rather, the doctrine only specifically requires incorporation of missing, mandatory clauses that "express a significant or deeply ingrained strand of public procurement policy" (*Id.*). Therefore, in the *Christian* case, the court incorporated a clause that allowed for the cancellation of a defense contract that was no longer needed. In the *General Engineering* case, the court incorporated a clause that was required by procurement regulations to be included in a time and materials contract because the clause prevented the government from having to make double payments that would be a waste of government funds (*Id.* at 780). The *General Engineering* court also noted that government contractors are "presumed to have

constructive knowledge of the federal procurement regulations," and therefore it should have come as no surprise that the mandatory incorporated clause would be included or read into the fixed price service contract (*Id.*).

Here, the clause at FAR Subsection 52.232-7(b)(7) is required by law to be included in a time and materials contract. The FAR prohibits payment of a profit/fee for materials – in this case, subcontracts. The history of the clause, as set out in the Federal Register, states that the prohibition is "consistent with the historical intent of the clause and the concept of a T&M contract. The recovery of profit or fee is accomplished as part of the labor hour portion of the T&M/LH contract" (FAR Case 2004-015, Payments Under Time-and-Materials and Labor-Hour Contract, 71 Fed. Reg. 74,655, 74,657 (Dec. 12, 2006)). As pointed out by the FAR Councils, when the government pays a separate profit or fee in the context of a time and materials contract, it is making a double payment because profit is already part of the fixed hourly rate. This rationale is similar to the explanation for the clause discussed by the *General Engineering* court. As noted above, CH2M Hill's legitimate and allowable profit was included in its hourly rates. Most certainly the clause in question, which is designed to prevent the federal government from paying double in the context of a time and materials contract, grows out of a significant or deeply ingrained strand of federal procurement policy that prohibits governmental waste of funds. Hence, under the Christian Doctrine, the FAR clause at Subsection 52.232-7(b)(7) is exactly the sort of mandatory clause that should and must be incorporated even if it is left out of a government contract.

The second basis presented by OGC for allowing the additional payment is that the CH2M Hill contract included an agency procurement clause (EPAAR 1552.232-73) that addressed payments for fixed rate services contracts but did not prohibit an additional profit/fee. That cannot and does not override or negate a FAR requirement. The FAR at Subsection 1.304(b)(2) specifies that agency acquisition regulations, except as required by law or when a deviation is authorized, "shall not" conflict or be inconsistent with FAR content. Further, the agency procurement regulations at EPAAR Section 1501.000 note that they are designed only to "implement and supplement" the FAR. Finally, there is no evidence that the agency acquisition manager sought approval from the EPA head of the contracting activity as required by EPAAR Subsection 1501.403 for a deviation from the FAR.

Conclusion

The FAR mandates that the CH2M Hill contract include a clause prohibiting a profit/fee in the CH2M Hill contract. The clause was not included but it should be read into the contract under the Christian Doctrine as a matter of law because it is designed to prevent double payment and therefore is the sort of clause that grows out of a significant and deeply ingrained federal procurement policy. Any agency procurement regulation that was included in the contract and that conflicts with or is inconsistent with this FAR clause does not override or negate the FAR. EPA paid CH2M Hill a significant sum ($1,524,196.44) for profit or fees on materials (i.e., the subcontracts) in violation of the FAR. That money must therefore be returned to the government.

Attachment C

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

CONTAINS PROCUREMENT SENSITIVE/CONFIDENTIAL BUSINESS INFORMATION

OFFICE OF
GENERAL COUNSEL

MEMORANDUM

To: John Bashista, Director, Office of Acquisition Management

From: Jonathan S. Baker, Office of General Counsel

Re: Office of Inspector General Report No. 13-P-0209 – Region 9 Response Action Contract (RAC) No. EPS-9-0804

Date: September 19, 2013

In response to OGC's June 21, 2013 memorandum, "Resolution of Office of Inspector General Report No. 13-P-0209, Opportunities for EPA-Wide Improvements Identified During Review of a Regional Time and Materials Contract, April 4, 2013," Steven M. Alderton, Senior Associate Counsel, OIG Office of Counsel issued a September 3, 2013 opinion concluding that FAR 52.232-7, Payments under Time-and-Materials and Labor–Hours Contracts, was required to be included in Region 9's RAC contract and that under that clause, EPA improperly paid the prime contractor, CH2M Hill, Inc. (Hill) additional "profit" for subcontracted construction work. The OIG concludes that EPA should pursue reimbursement of the additional profit paid to Hill. As discussed in our previous memorandum as well as below, we believe that the OIG is incorrect. EPA's payments to Hill were in accordance with law; FAR 52.232-7 was not required to be read into the contract, and even if it was, it does not prohibit the payments made to Hill.

Background

EPA Region 9 awarded the RAC contract to Hill on September 24, 2008. Under the contract, Hill provides professional architect and engineering (A&E) services, technical, and management services to EPA to support activities under the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA). The base period was 3 years with award terms for up to an additional 7 years. EPA exercised the first award term, extending performance to September 23, 2013. The contract is a fixed-rate indefinite delivery/indefinite quantity (ID/IQ) vehicle with a ceiling of $116,250,000.

The contract was procured under FAR Part 36 Brooks Act procedures. Under the Brooks Act, EPA first performed a technical evaluation of the offerors and ranked them. At that point, cost negotiations commenced with the most highly ranked firm -- Hill. In addition to providing A&E services, the statement of work includes prime contractor oversight and management of construction projects, and requires the prime contractor to subcontract all construction work on a competitive basis. In its cost proposal, Hill originally proposed a 10 percent profit element built into its fixed labor rates for A&E services and an additional 10 percent premium (profit) for oversight on subcontracted construction services. *See Summary of Acquisition Pre/Post Negotiation Memorandum* (September 23, 2008). During

cost negotiations, Hill demonstrated that that the market for A&E services and construction management/oversight are different – namely, that construction management/oversight is riskier and that such additional risk needed to be reflected in the contract's cost structure. Hill's proposed 10 percent premium (or profit) on overseeing subcontracted construction work reflected the existing market differential between A&E and construction oversight services. That additional risk could be captured either through higher fixed rates for every hour performed by Hill – regardless of whether they were performed doing A&E or construction oversight – or the additional construction oversight risk could be captured by a premium associated with only those tasks.

Under EPAAR 1515 404-71, the target range for profit on subcontracted work ranges from 1-4 percent. During cost negotiations, rather than capture additional construction oversight risk through a higher fixed rate for every hour that Hill performed under the contract, the Contracting Officer negotiated a four (4) percent "premium" to be paid to Hill only in performing construction management/oversight (reduced from the proposed 10 percent premium), as well as a reduction in the overall profit rate on Hill's fixed rates to 9.5 percent. While this premium rate structure could have been reflected by creating two separate fixed rates in the contract – one for A&E work and one for construction management/oversight – this premium rate for construction management/oversight was captured by adding a 4 percent premium (labeled as "profit") applicable to construction subcontracts only. [1]

Hill has been performing the contract since the September 24, 2008 award date. Hill has billed and EPA has paid over $1.5 million under the subcontract management/oversight premium. In its audit report, the OIG has questioned this premium payment to Hill and has recommended that EPA pursue recovery of these funds from Hill.

Discussion

1. The Region 9 RAC Contract Included a Proper Mandatory Payments Clause and EPA's Payments to Hill Were Proper

As we have previously discussed, we do not believe that the 4 percent premium for construction management/oversight on subcontractor labor (labeled as "profit") is prohibited by law or is otherwise unallowable. While it would have been clearer to have established two separate rates under the contract for A&E work and for construction management/oversight, the purpose of the premium was to compensate Hill for the additional risk specifically associated with construction management/oversight without spreading that risk over every hour performed on both A&E work and construction management/oversight by generally increasing the contract's fixed rates. The additional four percent premium on subcontracted construction services is consistent with Agency guidelines. *See* EPAAR 1515.404-71; *see also* FAR 15.404-4.

Moreover, contrary to the OIG's suggestion, EPA included a proper payment clause in the Region 9 RAC contract. EPAAR 1552.232-73, "Payments – Fixed-Rate Contract," is a mandatory clause that is

[1] As stated in OARM's January 24, 2013 response to the audit, Region 9 has committed to including a comprehensive set of rates in future contracts that segregates those functions associated with A&E work from those associated with construction oversight services. In addition, OAM surveyed other similar headquarters and regional contracts and determined that the pricing method at issue here was unique to this one Region 9 RAC contract.

required to be used in EPA fixed-rate contracts. This clause was codified in the Code of Federal Regulations (CFR) on March 8, 1984, and has been amended twice since then – On October 3, 2000, and on February 4, 2002.

EPAAR 1552.232-73 was properly added as a FAR supplemental clause in accordance with procedures set forth at FAR 1.3, 1.4, and 1.5. As a general matter, it is the Administrator of the General Services Administration (GSA), the Secretary of Defense and the Administrator of the National Aeronautics and Space Administration (NASA) that are statutorily required to "jointly issue and maintain ... a single Government-wide procurement regulation ... the Federal Acquisition Regulation." 41 U.S.C. § 1303(a)(1). Other executive agencies may only issue federal procurement related regulations that are "essential to implement Government-wide policies and procedures within the agency; and [are] additional policies and procedures required to satisfy the specific and unique needs of the agency." 41 U.S.C. § 1303(a)(2)(A) & (B). It remains the responsibility of the GSA Administrator to ensure consistency of agency procurement regulations with the FAR. 41 U.S.C. § 1303(a)(3).

The general authority for agencies to issue or authorize regulations that supplement the FAR is found in Subpart 1.3. Agency acquisition regulations are limited to those necessary to implement FAR policies and procedures within the agency or to additional policies, procedures, solicitation provisions or contract clauses that supplement the FAR to satisfy the specific needs of the agency. FAR 1.302. All agency-wide acquisition regulations are published in the Federal Register for comment and then codified in 48 CFR. FAR 1.303.

In addition to supplemental clauses to meet specific agency needs, agencies may promulgate deviations to the FAR under FAR Subpart 1.4. Deviations are policies, procedures, solicitation provisions, or contract clauses that are inconsistent with the FAR, but are necessary to meet an agency's specific needs or requirements. FAR 1.401, 1.402. Deviations may be issued on an individual or class basis. FAR 1.403, 1.404.

Under FAR Subpart 1.5, prior to publishing a proposed FAR supplemental regulation or deviation, an agency makes an internal determination that the proposed revision would alter the substantive meaning of any FAR coverage beyond the internal operating procedures of the agency. If so, then the proposed FAR supplement or deviation is processed for inclusion in the Federal Register, thereby providing the public with an opportunity to provide comments on the proposed FAR supplement or deviation. FAR 1.501-503.

Here, EPAAR 1552.232-73 was added to 48 CFR in 1984 and was amended through the public notice and comment process twice since its initial publication. EPAAR 1532.111 mandates its inclusion in indefinite delivery/indefinite quantity contracts like the Region 9 RAC contract

2 The OIG's Reliance on FAR 52.232-7, "Payments under Time-and-Materials and Labor-Hours Contracts" Is Misplaced.

In its September 3, 2013 opinion, OIG counsel opines that FAR 52.232-7, "Payments under Time-and-Materials and Labor-Hours Contracts," is a mandatory clause that should have been included in the RAC contract instead of EPAAR 1552.232-73. The opinion further argues that this FAR clause should be read into the contract under the "Christian Doctrine." *See G.L.Christian & Associates v. United States,* 161 Ct. Cl. 1, 312 F.2d 418. 160 Ct. Cl. 58, 320 F.2d 345, *cert. denied,* 375 U.S. 954 (1963), 170 Ct. Cl 902, *cert. denied,* 382 U.S. 821 (1965). In the OIG's view, this FAR clause's prohibition on payment of profit

on "materials" prohibited the premium payment made to Hill for construction oversight, and that EPAAR 1552.232-73's silence on this matter renders it inconsistent with the FAR clause and that its inclusion in the RAC contract without being labeled as a "deviation" renders it ineffective. As discussed below, the OIG is incorrect in several ways: (1) The Christian Doctrine does not require FAR 52.232-7 to be included in the contract; and (2) even if it did, the profit payment prohibition in that clause is inapplicable to the subcontracted construction services at issue here. As a result, EPAAR 1552.232-73 is not inconsistent with FAR 52.232-7, its inclusion in the contract was appropriate, and EPA's payment of a 4 percent premium to Hill for overseeing subcontracted construction services was not prohibited.

A. The "Christian Doctrine" Does Not Require EPA To Read FAR 52.232-7 Into The Region 9 RAC Contract

As a general matter, under the Christian Doctrine, a court may insert a clause into a government contract as a matter of law if that clause is required by federal regulation and underlying statutory authority. As noted in *General Engineering & Machine Works v. O'Keefe,* 991 F.2d 775 (Fed. Cir. 1993), the Christian Doctrine "does not permit the automatic incorporation of every required contract clause." Rather, the doctrine only requires incorporation of missing, mandatory clauses that "express a significant or deeply ingrained strand of public procurement policy." *Id.* at 779. However, the Christian Doctrine has also been used over the years to incorporate "less fundamental or significant mandatory procurement contract clauses such as a clause permitting correction of mistakes in bid (*Chris Berg, Inc. v. United States,* 426 F.2d 314, 317 (Ct. Cl. 1970), a regulation requiring a reasonable cancellation ceiling on a multiyear contract (*Applied Devices Corp. v. United States,* 591 F.2d 635, 640 (Ct. Cl. 1979), and a statute containing pricing rules (*Rough Diamond Co. v. United States,* 351 F.2d 636, 642-43 (Ct. Cl. 1965), *cert. denied,* 383 U.S. 957 (1966).

The *General Engineering* Court announced a three-step process for application of the Christian Doctrine: 1. is the clause mandatory; 2. does the clause express a significant or deeply ingrained strand of public procurement policy; and 3. is the clause written to benefit the party seeking incorporation. However, it did not provide definitive guidance on the second prong of that test. In a subsequent case, *S.J. Amoroso Construction Co. v. United States,* 12 F.3d 1072 (Fed. Cir. 1993), the Federal Circuit affirmed the Claims Court's decision to read the correct Buy American Act clause into a construction contract and denied the contractor's claim for the costs of complying with that clause. The Court concluded that the Buy American Act, in and of itself, evidences a significant and deeply ingrained strand of public policy, was significant because it had been in effect for many years, and that it was irrelevant whether the use of the wrong clause was intentional or inadvertent.

Of particular interest in this case is Judge Plager's concurring opinion which points out some of the troubling aspects of the Christian Doctrine and argues for very limited use thereof. He notes that the *G.L. Christian* case itself had a unique set of facts which led that court to fashion a special remedy. *Amoroso,* 12 F.3d at 1079. In the absence of such special circumstances:

> [t]here are well established doctrines available to a court for equitably adjusting the rights and duties of contracting parties ... permit[ting] a court to construe a contract in light of the behavior and presumed intent of the contracting parties. The so-called *Christian* doctrine is not among these recognized techniques and should be limited to the special circumstances that called it forth for three reasons..

> First, unlike traditional contract doctrines, the *Christian* doctrine is not tied to intent of the parties ... [which] ... provides contracting parties with a modicum of predictability (in interpreting contracts). Instead, the *Christian* doctrine would have courts interpret cases by invoking an abstract notion of a "significant or deeply ingrained strand of procurement policy" ... a standard that can be tied to anything or nothing, and is therefore inherently unpredictable.
>
> ...
>
> Second, the Government when contracting with the private sector for goods and services enjoys the same contractual rights and remedies as do all others. In addition, by virtue of its dominant role in the marketplace, the Government routinely grants itself privileges – like the right to terminate a contract for the Government's convenience without penalty – that are not available to other contracting parties... I see no reason for gratuitously granting the Government an even more favored position in its contract activity, and one based on abstract notions of "public policy;" to do so smacks more of autocratic rule than freedom of contract.
>
> Third, the *Christian* doctrine in effect grants the Government authority, without liability, to change its mind post-performance about what a contract was intended to require on the grounds that some provision, which was omitted intentionally or negligently, would, if present, have granted the Government valuable contract rights.... Absent predictable contract rights, the market will either refuse to participate or, more likely, simply increase the price of participation. The Government may save some money in the short run under this principle of "I know my contract rights when I see them," but in the long run, the public who pays the costs will be the losers.

Id. at 1079-80.

Effective February 12, 2007, FAR 52.232-7 was amended to add a prohibition on paying profit or fee to a prime contractor on materials. In doing so, the FAR Council noted that this change was consistent with the "historical intent of the clause and the concept of a T&M contract." However, this change is not rooted in statute, and the FAR Council's comment does not clearly demonstrate that this change expresses a "significant or deeply ingrained strand of public procurement policy." In light of that, coupled with the fact that premium rates for different types of services under a fixed-rate contract is not prohibited, and profit is not completely excluded on subcontracted services (*see* FAR 15.404-4 and EPAAR 1515.404-71), the Agency should not conduct a post-performance change to what this contract was intended to reflect – namely, a higher rate for construction oversight services than for architect and engineering services.

B. **Even Assuming For the Sake of Argument That FAR 52.232-7 Should Be Read Into The RAC Contract, The Profit Prohibition Does Not Apply To the Subcontracted Work Under The Contract.**

Even assuming that the Christian Doctrine requires that FAR 52.232-7 be read into the Region 9 RAC contract, we do not believe that the profit prohibition in that clause applies to this contract.

As discussed above, effective February 12, 2007, FAR 52.232-7 was amended to add the following provision: "Except as provided for in 31.205-26(e) and (f), the Government will not pay profit or fee to the prime Contractor on materials." FAR 52.232-7(b)(7). Contrary to the OIG's suggestion, "materials" in this prohibition *do not include all subcontracts*, but rather, are limited to "subcontracts for *supplies and incidental services* for which there is not a labor category specified in the contract." FAR 16.601 (a) and 52.232-7(b)(1)(ii) (emphasis supplied).

The subcontracts at issue here simply do not fit within this limited definition of "materials." They were for construction services, not supplies. Moreover, the subcontracted construction services for which Hill was paid an oversight premium were a significant portion of the work performed under the RAC contract. Approximately $38 million of the $110 million spent under this contract (34.5 percent) was for subcontracted services. Such a high percentage of subcontracted services can hardly be considered "incidental." Accordingly, even if FAR 52.232-7 was read into the contract as a matter of law, its profit prohibition on subcontracted supplies and incidental services simply does not apply in this case.

Conclusion

Based on our understanding of the facts of this contracting issue, we do not believe that the payment of a premium rate (labeled profit) to Hill for construction oversight work was improper. The contract reflected the agreement between the parties that A&E work and construction oversight work involved different risks and markets, and the contract included a properly promulgated EPA-specific payment clause that is required to be included in EPA fixed-rate ID/IQ contracts. We do not believe that the Christian Doctrine requires EPA to read FAR 52.232-7 into this contract. In any event, we also believe that the OIG is misreading that clause to prohibit prime contractor profit on significant subcontracted services. If you would like to discuss this matter further, please contact me at 202-564-4703 until October 4, 2013, or Ken Pakula at 202-564-4706.

cc: Ken Pakula, OGC

Attachment D

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

December 18, 2013

OFFICE OF
INSPECTOR GENERAL

MEMORANDUM

SUBJECT: Resolution of Office of Inspector General Report No. 13-P-0209, Opportunities for EPA-Wide Improvements Identified During Review of a Regional Time and Materials Contract, April 4, 2013

FROM: Steven M. Alderton, Senior Associate Counsel

TO: Carolyn Copper, Assistant Inspector General
Office of Program Evaluation

You requested that the Office of Inspector General (OIG) Office of Counsel respond to a second U.S. Environmental Protection Agency (EPA) Office of General Counsel (OGC) legal memorandum related to the above-referenced matter. The OGC memorandum is dated September 19, 2013, and was forwarded to the OIG on November 11, 2013. As discussed below, we are not persuaded by OGC's arguments.

By way of procedural background, this office issued a memorandum on September 3, 2013; that document analyzed an earlier OGC legal document dated June 21, 2013. In our September memorandum, we concluded that the Federal Acquisition Regulation (FAR) mandated that the CH2M Hill contract, a contract with a time and materials pricing arrangement, should have included a clause prohibiting a profit/fee (FAR Section 52.232-7(b)(7)). The contracting officer failed to include the mandatory clause. We opined that the mandatory clause should be read into the contract under the Christian Doctrine as a matter of law because the clause is designed to further a deeply engrained procurement principle--that being the prohibition of double payment of a profit/fee. We further opined that a related EPA Acquisition Regulation (EPAAR) clause did not override the FAR clause. We concluded that the $1,524,196.44 paid by the EPA for profit/fee to the contractor, CH2M Hill, was paid in violation of the FAR and that it should be returned to the government. (The factual background related to this matter was detailed in our September memorandum, and so it will not be included in this discussion.)

OGC's legal positions set out in its September 19 memorandum are discussed below. With the exception of one new argument, the memorandum reiterates the same positions as in its first document. No position taken in the second OGC memorandum warrants a revision to our conclusion that the FAR clause in question is applicable to the CH2M Hill contract, and that the EPA seemingly violated the FAR when it agreed to pay additional profit/fee to the contractor.

Analysis of Second OGC Memorandum

First, OGC reasserted its claim that the profit/fee in question was intended to be a "premium" rather than a profit/fee, and that therefore it was not in violation of the FAR clause. We are not persuaded by this position. Regardless of what one calls it, the payment functioned as profit/fee–on top of the negotiated fixed rate, and the parties perceived it as such. The contractor considered the 4 percent payment to be a profit/fee. The EPA contracting officer used the term "profit" in the contract.

Second, OGC restated its position that an EPAAR clause included in the CH2M Hill contract–that did not forbid a profit/fee--negated the mandatory FAR clause. But, as we stated in our September memorandum, the FAR at Subsection 1.304(b)(2) specifies that agency acquisition regulations, except as required by law or when a deviation is authorized, "shall not" conflict or be inconsistent with FAR content. Without the legal requirement or waiver, the EPAAR clause in the CH2M Hill contract cannot trump the FAR.

OGC now appears to be making the argument that the codification and amendments of the EPAAR clause–all of which took place before 2003–essentially constituted a deviation from the FAR clause in question. The weakness in this argument is that the FAR clause in question was not in existence when the EPAAR clause was codified and amended; the much earlier EPAAR clause cannot constitute a deviation from the later FAR clause.

Third, OGC again argued that the FAR clause should not be read into the contract as a matter of law under the Christian Doctrine. OGC quoted generously from a concurring opinion (not the majority opinion) in a federal case wherein the court used the Christian Doctrine to incorporate a clause into a government contract. The concurring judge suggested that the Christian Doctrine should be reserved for special circumstances. A concurring opinion, however, does not disturb the authority of majority opinions nor establish precedent concerning application of the doctrine.

The FAR at Subsection 32.111(a)(7) states that the FAR clause at 52.232-7(b)(7) "shall" be inserted "when a time-and-materials contract is contemplated." The contracting officer for the CH2M Hill contract, however, failed to follow the FAR requirement. The failure to include the requisite FAR clause leads to the fundamental question of whether the government should suffer negative consequences arising from the mistake. As detailed in our September memorandum, the Christian Doctrine holds that a procurement requirement mandated by law should be read into a contract as a matter of law if the requirement grows out of a deeply engrained procurement principle. We quoted from legislative history of the clause that shows the FAR Councils believed the clause to grow out of the historical intent and concepts relating to time and materials contracts. Further, and most importantly, the Councils stated that the intent behind the clause was to avoid the payment of profit/fee on top of the profit that was negotiated as part of the labor rate. In short, the key procurement principle at the core here is that the government must avoid double payment of profit.

In our September memorandum, we cited to a directly applicable Federal Circuit case (*General Engineering and Machine Works v. O'Keefe, 991 F.2d 775 (Fed. Cir. 1993)*) where the court stated that to not incorporate a missing provision into a contract when the law mandates incorporation and where a significant procurement principle is at stake would be to thwart congressional legislative policy (*Id.* at 779-80). In that case, like here, the Federal Circuit Court supported the government's decision to incorporate into a time and materials contract a mandatory, missing procurement clause that was designed to deter double payments and thus discourage "unnecessary and wasteful spending of

government money" (*Id.* at 780). The court added that a contractor is not disadvantaged when a missing clause is incorporated as a matter of law because government contractors "are presumed to have constructive knowledge of federal procurement regulations" (*Id.*). The facts of the *General Engineering* case are very similar to the fact pattern here; OGC has not provided applicable case law to support its position that the clause should not be incorporated. As we previously opined, we believe that avoidance of double payment reflects a deeply ingrained and significant procurement policy. Because of the important principle underlying the mandatory FAR clause at Section 52.232-7, the clause should be incorporated by law into the CH2M Hill contract.

Fourth, OGC raised a new argument. OGC contended that–even if the mandatory FAR clause were read into the contract under the Christian Doctrine as a matter of law–the clause does not apply to the facts in the CH2M Hill contract. The clause in question is applicable to a time and materials contract. OGC contends that the subcontracts for services at issue in this case did not fit within the definition of materials. The FAR definition of materials, included at Section 16.601(a), is, in part, as follows: "subcontracts for supplies and incidental services for which there is not a labor category specified in the contract." OGC concluded that the subcontracted services in the CH2M Hill contract do not fit the FAR definition because they constituted approximately one third of the total value of the contract and therefore they were not incidental. OGC did not provide a legal authority that supports its position.

Our research has not found legislative history or case law to help ascertain what the drafters of the definition of "materials" meant by "incidental services." But, Black's Law Dictionary (9th Edition) defines "incidental," as: "subordinate to something of greater importance; having a minor role." Using that legal definition, the percentage of services performed by the CH2M Hill subcontractors here is incidental to (read subordinate to) the work performed by the prime contractor. The major role (approximately two thirds of the value of the contract) was performed by the CH2M Hill prime contractor, and the minor role was performed by its subcontractors. Further, and importantly, the CH2M Hill subcontracted services fit the FAR definition of materials because there is no labor category in the contract that would cover them. Hence, one could reasonably argue–in line with a legal definition–that costs for subcontractor services here were incidental to total prime contractor costs.

Finally, it does not make sense that the FAR would allow for the payment of double profit when subcontracts for services are high in value; that would defeat the purpose underlying the mandated clause. Indeed, because the value of the CH2M Hill subcontractor incidental services here was relatively high, so also then was the degree of violation of a FAR clause that was designed to restrict a double profit/fee.

Conclusion

The OIG legal position is fairly straightforward. The CH2M Hill contract is a time and materials pricing arrangement. The FAR states that a clause prohibiting the payment of a profit/fee "shall" be included in all time and materials contracts. The FAR prohibition seemingly applies to subcontracting services, like those found in the contract in question, that are incidental or subordinate to work provided by the prime contractor. The contracting officer failed to follow the FAR and include the mandatory clause in the CH2M Hill contract. Case law directly supports the position that the FAR clause in question, because it is intended to preclude the government from paying double for profit/fee, is a critical procurement clause that grows out of an essential procurement policy. As such, the clause should be read into the contract as a matter of law pursuant to the Christian Doctrine. The contracting officer's mistake should not result in the wrongful government payment of $1,524,196.44 to a contractor for prohibited profit/fee. That money must be recaptured.

Attachment E

(The correct date for the memorandum attached hereto is March 25, 2014. Also, the correct date for Attachment 1 is March 18 through 20, 2014.)

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

March 25, 2013

OFFICE OF
INSPECTOR GENERAL

MEMORANDUM

SUBJECT: Resolution of Office of Inspector General Report No. 13-P-0209, Opportunities for EPA-Wide Improvements Identified During Review of a Regional Time and Materials Contract, April 4, 2013

FROM: Steven M. Alderton, Senior Associate Counsel

TO: Carolyn Copper, Assistant Inspector General
Office of Program Evaluation

This memorandum is in response to additional material provided to OIG by the EPA Office of General Counsel subsequent to the March 12 meeting between the IG and the CFO, in emails dated March 18 through 20, 2013. See Attachment 1. On March 20, OGC wrote that the legal issues in this matter appeared to center around two points: "1. The EPAAR clause in the contract was legally permissible and FAR 52.232.7 was not required in the contract; 2. Even if we can't agree to No. 1 above, a correct reading of FAR 52.232-7 and FAR's definition of incidental services, results in the conclusion that profit or fee on the subcontracted services here is not prohibited."

With regard to OGC's first legal position, OIG repeatedly stated in the evaluation report and in the prior two legal memoranda on this topic that the FAR clause at Section 52.232-7 was required by law to have been included in the Remedial Action contract. Specifically, the FAR at Subsection 32.111(a)(7) states that the FAR 52.232-7 "shall" be inserted "when a time-and-materials or labor-hour contract is contemplated." Given that the RA contract is a time and materials contract, we continue to disagree with the OGC position that FAR 52.232-7 "was not required in the contract." Further, the OIG has evidenced that the outdated EPAAR clause that was included in the RA contract, and that did not require the prohibition set out in the similar FAR clause, cannot be used by the agency to negate the FAR clause.

With regard to its second legal position listed above, OGC contends that the subcontracting work in the RA contract for which the government paid a four percent profit does not fit the FAR definition of "materials" and therefore the work was not covered by FAR 52.232-7. The FAR clause states that the government is prohibited from paying a profit to the prime contractor on "materials." In the case of the RA contract, the government paid profit on work performed by a subcategory of subcontractors. The FAR definition of "materials" at Section 16.601(a) includes "[s]ubcontracts for supplies and incidental services for which there is not a labor category specified in the contract." OGC most recently argued in the attached emails, in a variation from an earlier position, that the subcontractors' work should not be considered "incidental services" because it did not fit the FAR definition of incidental services in an architecture and engineering (A&E) contract, and also because there were labor categories for the subcontracting work in the RA contract.

The first question is whether the subcontracting activities listed in the RA contract fit the definition of "incidental services" for A&E contracts. OGC noted, with citations, that the FAR examples of services incidental to an A&E contract include: studies, investigations, surveying and mapping, tests, evaluations, consultations, comprehensive planning, program management, conceptual designs, plans and specifications, construction phase services and other related services. OGC indicated that this list of activities is different from the "construction" work performed by the RA contract subcontractors. However, the RA contract at clause B.5(d), a clause that covered the description of special subcontracting work for which a four percent profit was charged to the government, states that the work "include[s], but [is] not limited to: well-drilling, analytical services (when not provided by the government), special consultants to support technical projects or to serve as expert witnesses, aerial mapping, surveying, fencing, or construction activities associated with a Remedial Action." See Attachment 2. Contrary to OGC's characterization of the subcontracting work as simply "construction," the RA contract envisioned that the subcontractors would perform work related to the sort of activities outlined in the FAR as services incidental to an A&E contract. In short, the special subcontracting services fit the FAR definition.

The second question is whether there were in fact labor categories for the profit-related subcontracting activities in the RA contract. OGC asserted, without evidence, that there "are labor categories for construction labor" in the RA contract and that the subcontracting work had been charged in a manner consistent with those rates. However, a review of the RA contract language and actual invoices does not support OGC's position. RA contract clause B.5(d) indicates that the special category of subcontracting work for which a four percent profit was to be charged was to be treated as "separate and distinct from the amounts that may be negotiated for subcontractors which constitute part of the prime contractor's permanent contract team." A separate CLIN was established for the profit-related subcontracting work. (As noted in the clause, there were other subcontractors that were part of the prime contractor's team; they are not the focus of this discussion, however, because there was no charge for profit connected to their work.) The RAC subcontract-specific clause does not apply established labor rates to the separately treated subcontractors.

The invoice at Attachment 3 evidences how the special subcontract work was charged. Half way down the invoice is the category "Subpool;" this captures work performed by the subcontractors in question. Below that category is "Subpool Profit" – with the four percent profit calculations. Importantly, this information is treated as separate from the labor categories which were applied to the prime contractor and its team as listed at the top of the page. The evaluators did not find in the sample of invoices they reviewed that the "Subpool" work was charged by labor category. Supporting documents for "Subpool" work did not even break out labor from supplies; it simply used the initials "LS" for "lump sum." There is no evidence in the RA contract and related invoices that the subcontracting work for which a profit was attached had been charged to the government consistent with contractually established labor rates; to the contrary, all evidence points to the fact the work was treated as a separate lump sum charge with no apparent connection to labor rates. Hence, the RA contract clause and the related invoices indicate that in fact there were no labor categories associated with the specially subcontracted work.

In sum, OIG Office of Counsel continues to conclude that the FAR clause prohibiting profit on materials to a prime contractor should have been, by law, included in the RA contract. EPA did not include the clause. Instead, it included an outdated EPAAR clause that contradicted the

FAR clause, and that cannot be used to supplant the FAR. It also appears to be the case that the RA contract subcontracting work for which a four percent profit was charged (in contravention of the FAR), fits the FAR definition of "materials" because it is the sort of work that is incidental to an A&E contract, and it apparently was not charged consistent with contractually established labor rates.

Alderton, Steven M.

From: Alderton, Steven M.
Sent: Thursday, March 20, 2014 10:49 AM
To: Pakula, Kenneth; Redden, Kenneth
Cc: Larsen, Alan; Hanger, Eric; Lewis, Eric; Walker, Khadija; Baughman, Christine
Subject: RE: Proposed meeting re OIG Report No. 13-P-0209

Ken,

Thanks for your continued efforts to explain your position.

With regard to the first point set out below, we most certainly do not agree with your position. Of course it was "legally permissible" to include the EPAAR clause. What is not "legally permissible" is to use an EPAAR clause – that fails to include a specific prohibition set out in a requisite FAR clause – to supplant the FAR clause. As you know, a legally mandated FAR clause with a specific prohibition cannot be negated by an EPAAR clause; it can only be supplemented by it. As for whether the FAR clause was in fact required in the RAC contract, the FAR at Subsection 32.111(a)(7) states that FAR clause 52.232-7 "shall" be inserted "when a time-and-materials or labor-hour contract is contemplated." Given that the RAC contract is a T&M contract, then your argument that the FAR clause "was not required" in the contract fails.

With regard to your second point, there seems to be more than a slight shift or addition of an argument. Jon Baker, in his September 19 memorandum, acknowledged that the subcontracts fell generally into the category of "services for which there is not a labor category specified in the contract." Seemingly he should have known whether that was factually correct given that he worked on the RAC contract. His only point of contention was that the subcontracted "construction services" were too high in value to be considered "incidental." Hence we focused on the definition of "incidental." Below, if I understand you correctly, you now take the position that – by definition -- the subcontracted work flat out does not fit into the category of services, incidental or otherwise, "for which there is not a labor category specified in the contract." That seems to be a significant shift in argument and interpretation of relevant facts.

We will focus on your material set out yesterday, and try to determine whether there is legal and/or factual merit before the meeting on Wednesday.

Steve

From: Pakula, Kenneth
Sent: Thursday, March 20, 2014 9:04 AM
To: Alderton, Steven M.; Redden, Kenneth
Cc: Larsen, Alan; Hanger, Eric; Lewis, Eric
Subject: RE: Proposed meeting re OIG Report No. 13-P-0209

Steve,

OGC isn't abandoning any arguments, we are just trying to shift the focus to where it can more easily lead to resolution – which, in my opinion, centers on the following two points:

1. The EPAAR clause in the contract was legally permissible and FAR 52.232.7 was not required to be in the contract;

2. Even if we can't agree to No. 1 above, a correct reading of FAR 52.232-7 and the FAR's definition of incidental services, results in the conclusion that profit or fee on the subcontracted construction services here is not prohibited.

I believe Jon Baker's reference to the percentage of subcontracted work as being too high to be "incidental" was simply an additional argument provided if one were to use the commonly accepted definition of "incidental." Quite frankly, he should have initially included the FAR and case law references I subsequently provided to the OIG which reveal that the FAR and case law address the parameters of the term "incidental services." So, we really don't need to be focusing on the common use of the term or Black's Law Dictionary's definition – both are irrelevant given the FAR and case law guidance.

Ken Pakula
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Procurement Law Practice Group
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From: Alderton, Steven M.
Sent: Wednesday, March 19, 2014 5:53 PM
To: Pakula, Kenneth; Redden, Kenneth
Cc: Larsen, Alan; Hanger, Eric; Lewis, Eric
Subject: RE: Proposed meeting re OIG Report No. 13-P-0209

Ken,

I'll review your response in greater detail later. Also, this has to be forwarded to the evaluators because they are intimately familiar with the contract in question.

But, generally, am I to now understand that you have decided to abandon OGC's argument re "incidental services" as set out in the OGC September 19 memorandum? That document referred to the subcontracted work as "construction services." Also, that document, without providing legal support, determined that the thirty percent figure of subcontracted services was too large be considered "incidental services." We did not raise any of these points; OGC did. So, for clarity sake, is the OGC "incidental services" set out in the September 19 memo no longer on the table?

Steve

From: Pakula, Kenneth
Sent: Wednesday, March 19, 2014 5:17 PM
To: Alderton, Steven M.; Redden, Kenneth
Cc: Larsen, Alan; Hanger, Eric; Pakula, Kenneth
Subject: RE: Proposed meeting re OIG Report No. 13-P-0209

Steve,

I think the way to look at this is not to focus on the amount of work done or the percentages of work done and/or whether the work came after or subsequent to the work done under the prime contract. Rather, simply look at the language of FAR 52.232-7:

7) Except as provided for in 31.205-26(e) and (f), the Government will not pay profit or fee to the prime Contractor on materials.

52.232-7 states that the government will not pay profit to the prime on materials. Scroll up within the same clause to the definition of materials -

b) *Materials.*

(1) for the purposes of this clause—

(i) *Direct materials* means those materials that enter directly into the end product, or that are used or consumed directly in connection with the furnishing of the end product or service.

(ii) *Materials* means—

(A) Direct materials, including supplies transferred between divisions, subsidiaries, or affiliates of the Contractor under a common control;

(B) Subcontracts for supplies and incidental services for which there is not a labor category specified in the contract;

(C) Other direct costs (*e.g.*, incidental services for which there is not a labor category specified in the contract, travel, computer usage charges, etc.); and

(D) Applicable indirect costs.

Subcontracted construction work is not "supplies" nor is it "incidental services for which there is not a labor category specified in the contract" – My reference to FAR 36.6 and 2.101 was to show that the FAR considers incidental services to be services tangentially related to the main work being done, i.e., if the work is A/E work then, incidental work would be mapping, surveying, etc. In addition, there are labor categories for construction labor, most likely non-professional labor – I believe often referred to as category P-4 labor. So, because the construction work we are talking about does not fit within 52.232-7's definition of "materials," the fee prohibition does not apply to the subject work.

The above definition of incidental services as tangentially related is also well supported in GAO case law- see the Forest Service case.

I hope this helps clarify OGC's position.

Ken

Ken Pakula
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Procurement Law Practice Group
Office of General Counsel
U.S. Environmental Protection Agency
1200 Pennsylvania Avenue, N.W.
Washington, D.C.
Phone: 202.564.4706
Fax: 202.565.2478

From: Alderton, Steven M.
Sent: Tuesday, March 18, 2014 5:12 PM
To: Pakula, Kenneth; Redden, Kenneth
Cc: Larsen, Alan; Hanger, Eric
Subject: RE: Proposed meeting re OIG Report No. 13-P-0209

Ken,

Thanks for the quick response. But, alas, I remain confused.

In the second OGC opinion in this matter, dated September 19, 2013, a new argument was introduced on pages five and six. As I understand it, OGC contended in this new position that even if the requisite FAR clause in question had been included in the contract, it would not have been applicable given certain facts related to the contract. OGC correctly noted that the FAR clause prohibited payment of a profit to a prime contractor for materials charged in the context of a time and materials contract. OGC then turned to the FAR definition of "materials." That definition at Section 16.601(a) states, in part, that materials include "subcontracts for supplies and incidental services for which there is not a labor category specified in the contract." The subcontracted work was for construction services. OGC then concluded that the subcontracted services do not fit the definition of "materials" because they constituted approximately one third of the total value of the contract. OGC did not provide legal support for its interpretation or definition of "incidental services."

On December 18, 2013, OIG forwarded its response to the September 19 OGC memorandum. In the discussion about the argument above, we noted that we did not find case law or legislative history to help define what number-wise the FAR meant by "incidental services" – as referenced in the definition of "materials." Hence, we turned to Black's Law Dictionary which defined incidental as "subordinate to something of greater importance." By that definition, most certainly the approximately one third of contracted subcontractor services constituted an incidental part of the total contract. We also raised a second argument relating to the purpose of the FAR profit prohibition.

I expected OGC to forward legal support for the position that, in line with the FAR definition of "materials," thirty percent of the value of a contract does not constitute "incidental services" because it is too high of an amount. But, the material below does not seem to address when services are incidental (say 15%) or not incidental (say 50%). We continue to take the position that the thirty percent figure fits into the general definition of "incidental" because it's subordinate to the seventy percent of the remaining work that was done on the contract.

It is not clear to me how the material highlighted below supports the original OGC argument.. Perhaps you can briefly walk me through your analysis based on the material below.

Steve

From: Pakula, Kenneth
Sent: Tuesday, March 18, 2014 1:07 PM
To: Alderton, Steven M.; Redden, Kenneth
Cc: Larsen, Alan; Hanger, Eric
Subject: RE: Proposed meeting re OIG Report No. 13-P-0209

Steve –

OGC's position was fully briefed in the meeting last week. In addition, when you and I spoke on the phone the week prior, I provided you with all of the support for OGC's interpretation of "incidental services" that I relied on in last week's meeting. In short, OGC's position regarding the definition of "incidental services" is based upon the language contained in FAR Part 36.601-4(a)(3), FAR 2.101(a)(3), case law - including but not limited to 68 Comp Gen 555 (Matter of Forest Service,) and even GSA's website (FAQ #23).

FAR 36.601-4 Implementation.

(a) Contracting officers should consider the following services to be "architect-engineer services" subject to the procedures of this subpart:

(1) Professional services of an architectural or engineering nature, as defined by applicable State law, which the State law requires to be performed or approved by a registered architect or engineer.

(2) Professional services of an architectural or engineering nature associated with design or construction of real property.

(3) Other professional services of an architectural or engineering nature or services incidental thereto (including studies, investigations, surveying and mapping, tests, evaluations, consultations, comprehensive planning, program management, conceptual designs, plans and specifications, value engineering, construction phase services, soils engineering, drawing reviews, preparation of operating and maintenance manuals and other related services) that logically or justifiably require performance by registered architects or engineers or their employees

FAR 2.101(a)(#) "Architect-engineer services," as defined in 40 U.S.C. 1102, means--

(1) Professional services of an architectural or engineering nature, as defined by State law, if applicable, that are required to be performed or approved by a person licensed, registered, or certified to provide those services;

(2) Professional services of an architectural or engineering nature performed by contract that are associated with research, planning, development, design, construction, alteration, or repair of real property; and

(3) Those other professional services of an architectural or engineering nature, or incidental services, that members of the architectural and engineering professions (and individuals in their employ) may logically or justifiably perform, including studies, investigations, surveying and mapping, tests, evaluations, consultations, comprehensive planning, program management, conceptual designs, plans and specifications, value engineering, construction phase services, soils engineering, drawing reviews, preparation of operating and maintenance manuals, and other related services.

Here is an excerpt from the above-referenced Forest Service case:

The second part of the definition of A-E services included "incidental services that members of these (A-E) professions and those in their employ may logically or justifiably perform." 40 U.S.C. Sec. 541. interpreted this language as meaning that Brooks Act procedures are applicable where the services may "logically or justifiably" be performed by A-E firms and where such services are "incidental" to other professional A-E services. Thus, as stated above, we interpreted the Brooks Act as requiring incidental services to be procured with Brooks Act procedures only when provided by an A-E firm in the course of providing other A-E services and as part of an A E project. AAA Engineering and Drafting, Inc., et al., 66 Comp.Gen. at 440.

From GSA's website:

1. **What services are subject to QBS procedures in FAR 36.6?**

   In accordance with FAR 36.601-4, contracting officers should consider the following services to be A/E services and thus subject to QBS procedures:

1. Professional services of an architectural or engineering nature, as defined by applicable state law, which the state law requires to be performed or approved by a registered architect or engineer;
2. Professional services of an architectural or engineering nature associated with design or construction of real property;
3. Other professional services of an architectural or engineering nature or services incidental thereto (including studies, investigations, surveying and mapping, tests, evaluations, consultations, comprehensive planning, program management, conceptual designs, plans and specifications, value engineering, construction phase services, soils engineering, drawing reviews, preparation of operating and maintenance manuals, and other

related services) that logically or justifiably require performance by registered architects or engineers or their employees; and

4. Professional surveying and mapping services of an architectural or engineering nature. Surveying is considered to be an architectural and engineering service and shall be procured pursuant to FAR 36.601 from registered surveyors or architects and engineers. Mapping associated with the research, planning, development, design, construction, or alteration of real property is considered to be an architectural and engineering service and is to be procured pursuant to FAR 36.601.

In light of the above, I don't believe that a formal memorandum is necessary.
Ken

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Phone: 202.564.4706
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From: Alderton, Steven M.
Sent: Tuesday, March 18, 2014 12:37 PM
To: Redden, Kenneth; Pakula, Kenneth
Cc: Larsen, Alan; Hanger, Eric
Subject: Proposed meeting re OIG Report No. 13-P-0209

Thank you for the invitation to a meeting this week to discuss legal issues relating to the above-referenced report. We would like to meet with you to discuss the issues. However, there is one legal issue that has not been fully briefed by OGC. The issue was raised at the end of OGC's September 19, 2013, legal memorandum, and relates to the definition of "incidental services." OGC did not provide legal support for its interpretation of that phrase, and so it was difficult to fully respond to the issue in the OIG December 18, 2013, legal memorandum. Ken Pakula mentioned on the phone that you have legal support for your position. Therefore, before we meet, we ask that you forward a written legal position relating to your definition of "incidental services" so that we can have a potentially fruitful discussion.

Please contact me if you have questions.

Regards,

Steve Alderton, J.D., Ph.D.
Senior Associate Counsel
Office of Counsel
EPA Office of Inspector General
202-566-0841

B.5 SUBCONTRACTING CLIN

(a) This contract includes a specified cost ceiling designated exclusively for work that is to be performed by subcontractor(s) and managed by the prime contractor. The cost ceiling (the "Subcontracting CLIN") is: $30M

(b) Subcontracts issued under this clause shall be either performance-based or fixed price. The Contractor must request and receive concurrence from the Contracting Officer (CO) prior to entering into any subcontract other than performance based or fixed price.

(c) All work expended in task orders for this work will be recorded and reported to EPA as required in the Reports of Work (Attachment 4) .

(d) This subcontracting CLIN is separate and distinct from amounts that maybe negotiated for subcontractors which constitute part of the prime contractor's permanent contract team. All subcontracting, above the micro purchase threshold, which is to be accomplished through this subcontracting CLIN must be competed by the prime contractor, unless written approval to the contrary is obtained from the EPA CO. Specific activities which generally necessitate utilization of the CLIN include, but are not limited to: well-drilling, analytical services (when not provided by the Government), special consultants to support technical projects or to serve as expert witnesses, aerial mapping, surveying, fencing, or construction activities associated with a Remedial Action (RA).

(e) The amount specified for the Subcontracting CLIN is an estimate only. The estimated amount for Subcontracting CLIN may be greater than or less than the amount specified as long as the maximum contract ceiling amount is not exceeded.

(f) If the full subcontracting CLIN dollars are under-utilized, there may be a unilateral decrease in the subcontracting CLIN representing the unused portion of the subcontracting CLIN inclusive of associated costs.

Substitute for Form 1035

PUBLIC VOUCHER FOR PURCHASES AND SERVICES OTHER THAN PERSONAL

Region 9 Billing No.: 020

US ENVIRONMENTAL PROTECTION AGENCY
RTP-FINANCIAL MANAGEMENT CENTER
MAIL DROP - D143-02
RESEARCH TRIANGLE PARK, NC 27711

Contract No. EP S9 08 04
CH2M HILL, INC
P. O. BOX 27-100
KANSAS CITY, MO 64180

Task Order No.: 050-RARA-0917
IMM SPRING CREEK RA-PART 2 Voucher No. 15

Reporting Period From: 07/31/2010 To: 08/27/2010

MAJOR COST ELEMENTS:	HOURS		AMOUNTS	
Labor Category	Current	Cumulative	Current	Cumulative
Principal Engineer/Scientist/Specialist	193.0	6,141.0	$45,426.41	$1,442,481.83
Senior Engineer/Scientist/Specialist	51.0	4,025.0	$10,457.04	$822,427.80
Project Engineer/Scientist/Specialist	94.2	11,675.1	$14,774.33	$1,827,772.01
Staff Engineer/Scientist/Specialist	199.0	8,324.2	$22,481.03	$938,863.98
Junior Engineer/Scientist/Specialist	13.5	2,718.6	$1,139.81	$229,360.80
Senior Technician	13.6	968.9	$1,630.52	$115,896.27
Technician	2.5	217.7	$171.95	$14,973.41
Administrative and Clerical	105.8	3,834.4	$7,818.62	$282,911.42
TOTAL LABOR	672.6	37,904.9	$103,899.71	$5,674,687.52
Other ODCs			$4,406.24	$247,148.10
Travel			$4,604.88	$264,632.44
Subpool			$184,771.73	$10,709,806.59
TOTAL NON-LABOR			$193,782.85	$11,221,587.13
Subpool Profit			$7,390.87	$428,392.27
TOTALS - CURRENT AND CUMULATIVE			$305,073.43	$17,324,666.92
AMOUNT DUE THIS VOUCHER			$305,073.43	
CH2M HILL INC			$269,418.74	$14,992,776.22
CH2M Hill Affiliates			$29,784.19	$1,603,065.36
Team Subcontracts				
CFEST INC			$0.00	$0.00
CLEAR CREEK HYDROLOGY INC			$0.00	$236,185.82
CRITIGEN LLC			$1,067.00	$219,505.80
DAHL ENVIRONMENTAL ASSOCIATES			$0.00	$0.00
E2 CONSULTING ENGINEERS INC			$4,803.50	$273,133.72
ENVIRONMENT INTERNATIONAL GOVERNMENT LTD			$0.00	$0.00
Total Team Subcontracts			$5,870.50	$728,825.34
TOTALS BY FIRM - CURRENT AND CUMULATIVE			$305,073.43	$17,324,666.92

*** This voucher contains confidential business information *** Prj# 392063