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

AUG 6 2014

DECISION MEMORANDUM

DEPUTY ADMINISTRATOR

SUBJECT: 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: Robert Perciasepe
Deputy Administrator

TO: Arthur Elkins
Inspector General

Craig E. Hooks
Assistant Administrator
Office of Administration and Resources Management

Jared Blumenfeld
Regional Administrator, Region 9

In January 2012, the United States Environmental Protection Agency's (EPA or agency) Office of Inspector General (OIG) began an audit of EPA Contract Number EP-S9-08-4 (the Contract). The Contract was awarded by the EPA's Region 9 to CH2MHill, Inc. (Hill), and is known as a Remedial Action Contract (RAC). RACs are contracts for various remedial clean-up activities at particular sites that qualify for environmental remedial actions under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA).

While Hill was the prime contractor on the Contract, the Contract required Hill to hire subcontractors for certain actions taken under the Contract, and required Hill to oversee the actions taken by the subcontractors. In return for overseeing the work of the subcontractors, the Contract called for Hill to be paid an amount equal to 4% of the costs billed by the subcontractors.

During its audit, the OIG questioned this particular provision of the Contract. The OIG and the agency sought to resolve the OIG's questions informally through a series of meetings between staff of the relevant offices. Eventually, the matter was moved into the EPA's Audit Dispute Resolution Process, which is codified in EPA Manual 2750. Despite these now formal attempts, no resolution was reached, and the matter has been presented to me for resolution.

After considering all of the facts and arguments before me, I conclude that the Contract was consistent with all agency and government-wide regulations and laws.

I. BACKGROUND

EPA Region 9, awarded a RAC to Hill on September 24, 2008 (Contract No. EP-S9-08-04). The Contract has two phases: a remedial design phase and a remedial implementation phase. Under the design phase, Hill provides professional architect and engineering (A&E) services related to the design of the remedy selected CERCLA. Under the implementation phase, in order to avoid a potential conflict of interest in the design phase, the Contract requires Hill to hire subcontractors to perform all build activities. The Contract requires Hill to manage the subcontracts and oversee the work of the subcontractors during the implementation phase of the Contract.[1] For this work during the implementation phase, the Contract calls for Hill to be paid an amount equal to 4% of the total cost of the work undertaken by the subcontractors. The Contract is described in more detail Attachment A.

By report dated April 4, 2013, and entitled "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," the OIG made five recommendations to the EPA's Office of Acquisition Management (OAM) regarding the Contract. To date, OAM has satisfactorily responded to the OIG with respect to three recommendations. Those recommendations, and the agency's response, are not at issue here.

Two of the five recommendations were not accepted, however, and are the subject of this Audit Dispute Resolution Process. Those two recommendations relate to the provision of the Contract that calls for Hill to be paid an amount equal to 4% of the total cost of the work undertaken by the subcontractors. Specifically, those recommendations (Nos. 3 and 4 in the OIG Report) are to direct the CO for Contract EP-S9- 0804 and any Region 9 time and materials contract containing similar profit payment language to: (1) remove the profit clause or terminate the contract so that Region 9 no longer has to pay profit on subcontracts and; (2) recover the 4 percent profits paid.

II. PROCEDURAL BACKGROUND

This is the final Agency decision pursuant to Step 3 of the Internal Agency Audit Dispute Resolution Process, EPA Manual 2750, Part II, § B.1.d. Beginning in August 2013, a series of meetings between the OIG and OAM occurred wherein the parties attempted to resolve all the recommendations raised in the OIG's Report. Eventually, all but two of the recommendations were resolved. Despite additional meetings and the issuance of multiple legal memoranda from

[1] According to the Statement of Work, Hill's responsibilities under the Contract include, but are not limited to: These services include but are not limited to: the performance of site management, remedial investigation and feasibility studies; engineering services to design remedial actions; and construction management for implementing remedial actions, including issuing and managing subcontracts for construction of the selected remedy and engineering services in overseeing construction. See Contract No. EP-S9-08-4, Attachment 1, Statement of Work (SOW), page 1-3.

both the Office of General Counsel (OGC) and the OIG Office of Counsel, two related recommendations remained in dispute.

Pursuant to EPA Manual 2750, the OIG then elevated the disputed issues to the Office of the Chief Financial Officer where resolution was attempted, but not reached, in a March 12, 2014 meeting. Because the remaining issues in dispute involve a matter of legal interpretation, OGC met with OIG Counsel on March 26, 2014 in another attempt to resolve the remaining dispute, which was also unsuccessful. The OIG and EPA then met with me on May 29, 2014, to "present the issue template for resolution." EPA Manual 2750, Part II, § B.3.d. The dispute is now before me for decision.

III. ISSUE BACKGROUND

The two related OIG recommendations that remain in dispute are based upon the OIG's assertion that the Contract was improper because it did not contain a specific payment clause, Federal Acquisition Regulation (FAR) Clause 52.232-7 (Payments under Time-and-Materials Labor-Hour Contracts). The OIG concludes that the absence of the aforementioned clause was improper and led to an impermissible payment of "profit" based on subcontractor oversight costs.

A. OIG POSITION

The OIG argues that FAR Clause 52.232-7 should have been included in the subject contract but was not. The OIG argues:

> 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.' ... The clause states that 'the Government will not pay profit or fee to the prime contractor on materials.' ... 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[.]' OIG Memorandum to Robert Perciasepe, April 10, 2014, page 1, ¶ 4.

The OIG concludes, based upon the above interpretation of FAR 32.111(a)(7) and FAR Clause 52.232-7, that "[t]he subcontracting work fit the FAR definition of 'materials' because it was described in the contract [Clause B.5(d)] 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." Id. at 2, ¶ 1. If the subcontracting work constitutes "materials," the OIG reasons, FAR clause 52.232-7 prohibits the 4% fee paid to Hill under the Contract. The OIG further argues that the absence of FAR Clause 52.232-7, and the ability to recoup the 4% paid to Hill under the contract, can be rectified by application of what is known as the Christian Doctrine. OIG Memorandum to Carolyn Copper, September 3, 2013, at 3, ¶ 1. Generally, 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.

Finally, by memorandum dated June 5, 2014, in response to my request for further elucidation of the issue, the OIG addresses the parameters of FAR 52.232-7's prescriptive clause, FAR 32.111(a). FAR 32.111(a) states: "The contracting officer shall insert the following clauses, appropriately modified with respect to payment due dates, in accordance with agency regulations ---[.]" The OIG concludes that FAR 32.111(a) requires the inclusion of FAR 52.232-7 in all time and materials contracts because "... agency regulations, except as required by law or when a deviation is authorized, 'shall not' conflict with or be inconsistent with FAR content." Id. at 2, ¶ 2. Similarly, the OIG also asserts that: (1) inclusion of an alternative Agency payment clause, EPAAR Clause 1552.232-73 (Payments – Fixed Rate Services Contract), did not adequately protect the Agency's interests and; (2) an EPAAR clause "cannot override or negate a FAR requirement." Id., at 3, ¶ 2.

The OIG ultimately concludes that the Agency violated the FAR, which resulted in a $1,524,196.44 overpayment to Hill that must be recovered.

B. AGENCY POSITION

The Agency contends that the contract contained a properly promulgated payment clause, significantly, one that had been subjected to notice and comment rulemaking. Specifically, EPAAR Clause 1552.232-73 (Payments - Fixed-Rate Services Contract) which allows for the payment of a fee to a prime contractor for subcontract construction oversight work. Moreover, the Agency contends that the OIG did not accurately or fully cite the prescriptive clause for FAR 52.232-7 (the clause the OIG argues must be included in the subject contract). The Agency avers that the prescriptive clause for FAR 52.232-7 found at FAR 32.111(a) (7), states that "[t]he contracting officer shall insert [FAR 52.232-7] . . . *in accordance with agency regulations*" (emphasis added). The Agency concludes that, because EPA regulations clearly allow for the use of properly promulgated EPAAR clauses and the Contracting Officer did include a proper EPAAR payment clause in lieu of FAR 52.232-7 in the contract, the Contracting Officer acted "in accordance with agency [EPA] regulations" and thus was not required to include FAR 52.232-7 in the contract.

The Agency also disputes the OIG's reading of FAR 52.232-7. EPA asserts that, while FAR 52.232-7 prohibits payment of profit on "materials," the clause further defines "materials" as "subcontracts for supplies and incidental services for which there is not a labor category specified in the contract." Because the construction subcontracts under the RAC prime contract are not for supplies, FAR 52.232-7 does not apply to the subject contract based on that portion of the definition of materials. Failing to meet the "supplies" definition of the term "materials," the OIG argues in the alternative that the construction subcontracts are "incidental services" to the RAC prime contract; the Agency asserts they are not. The Agency argues that the OIG's position would lead to the result that every subcontract for services under all of the prime contracts across the entire Federal government are "incidental."

In support of its position that the use of EPAAR Clause 1552.232-73 was proper and that the 4% fee paid to Hill is legally permissible in this circumstance, , the Agency points to the fact that the FAR allows prime contractors to charge a profit on subcontractor costs as long as that

profit is not an "excessive pass-through charge." FAR 15.408(n); FAR 52.213-23. The Agency adds that an "excessive pass-through charge" is specifically defined as not including charges for the costs of managing subcontracts and any applicable profit or fee based on such costs. FAR 52.215-23(a).

In response to the OIG's argument that the subcontracting work at issue "... fit[s] 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," the Agency examined the clause relied upon by the OIG to reach its conclusion, Clause B.5(d). The Agency contends that the mere fact that "construction activities" are included in a list of activities that one might consider incidental does not make all "construction activities" incidental. The Agency adds that Clause B.5(d) is an administrative clause intended to address the segregation of non-team subcontracting costs and was never meant to define "incidental services." The Agency references Attachment 13 of the contract where "incidental services" are addressed for the purposes of the Contract; absent from Attachment 13 is any reference to oversight of subcontractor construction work.

The Agency also cites the Contracting Officer's pre-award reliance on EPAAR 1515.404-471 (EPA Structured Approach for Developing Profit or Fee Objectives), a provision that also went through notice-and-comment rulemaking, and specifically allows for a fee for subcontracting oversight. EPAAR 1515.404-471(D) (ii)(c)(2) states, in pertinent part, "Greater profit opportunity should be provided under contracts requiring a high degree of professional and managerial skill ...." In the instant case, EPA required the RAC prime contractor to subcontract all construction work (i.e., implementation of CERCLA remedial actions), yet retain overall responsibility and liability for overseeing this complicated work. Accordingly, the EPA Contracting Officer negotiated a four percent (4%) fee with Hill (significantly less than the ten percent (10 %) requested by Hill in pre-award negotiations) to be applied to the cost of subcontract construction oversight. See Contract No. EP-S9-08-04, Post-Negotiation Summary, at 30. The Agency notes that a four percent (4%) fee for overseeing the subcontract construction work clearly falls within the 1-4% profit parameters contained within EPAAR 1515.404-471.

Finally, in regard to the application of the Christian Doctrine, the Agency contends that the Doctrine only allows for insertion of a clause into a government contract as a matter of law if that clause is required by federal regulation and underlying statutory authority. The Agency adds that, while courts are not always consistent in their application of the Christian Doctrine, they do agree that it only applies to "a mandatory clause that expresses a significant or deeply ingrained strand of public procurement policy." EPA ultimately concludes that, because the prescriptive clause for FAR 52.232-7 states that inclusion is subject to agency regulations, FAR 52.232-7 is not a mandatory clause and, therefore, the Christian Doctrine is not applicable to the subject case.

IV. DECISION

Based upon the presentation and analyses of the issues in the attached copies of memoranda prepared by the OIG, OARM and OGC, I find that the provision in the Contract that

paid Hill an amount equal to four percent (4%) of the cost of activities performed by the subcontractors for oversight of subcontracted construction work was legally permissible and, therefore, not in contravention of the FAR or applicable procurement statutes and regulations. In addition, I have not been presented with, nor am I aware of, any viable legal theory that would now permit the Agency to seek the monies paid to Hill for services rendered, accepted, approved, and paid for by the Agency. Finally, the significance of the fact that the Contracting Officer's use of a four percent (4%) fee for subcontractor oversight as opposed to simply increasing the contractor's overall fixed rate, regardless of whether the work addressed by said rate was for oversight, actually saved the Agency (and therefore the American taxpayer) money cannot be overlooked.

The basis for my decision is as follows. First, I must conclude that the Agency's inclusion of EPAAR clause 1552.232-7 in lieu of FAR Clause 52.232-7 was proper. Codified in the Code of Federal Regulations (CFR) in March 1984, EPAAR 1552.232-73 is a mandatory clause required by EPAAR 1532.111 to be included in all fixed-rate contracts. Moreover, EPAAR 1552.232-73 was properly added to the Agency's regulations as a FAR supplemental clause in strict accordance with procedures set forth in FAR Subparts 1.3 (Agency Acquisition Regulation) and 1.5 (Agency and Public Participation). In accordance with FAR Subpart 1.5, EPAAR 1552-232-73 was added to Title 48 of the CFR in 1984 and amended through the public notice-and-comment rulemaking process twice since its initial publication. In short, EPAAR 1552.232-73 is a proper clause for inclusion in Agency contracts.

Second, with regard to whether FAR 52.232-7 was required to be included in the contract, I find that its inclusion was not required.[2]

The OIG argues that the prescriptive clause for FAR 52.232-7, FAR 32.111(a), requires that 52.232-7 be included in all time and materials contracts and that inclusion prevents the payment of any fee for subcontract oversight whatsoever. I believe that the OIG's interpretation of FAR 32.111(a) is incorrect. First, I find that FAR 52.232-7 was not required to be included in the Contract. The prescriptive clause for FAR 52.232-7, found at FAR 32.111 specifically states that 52.232-7 shall be inserted "in accordance with agency regulations." I find that the agency's regulations properly allowed for the use of an alternate payment clause.

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[2] In addition, I do not agree with the OIG that the Christian Doctrine would support inclusion at this juncture if I had concluded the provision should have been included. The Christian Doctrine allows for insertion of a clause into a government contract as a matter of law if that clause is required by federal regulation and underlying statutory authority. The Christian Doctrine only applies to "a mandatory clause that expresses a significant or deeply ingrained strand of public procurement policy." In the instant case, because the prescriptive clause for FAR 52.232-7 states that inclusion is subject to agency regulations, it is apparent to me that FAR 52.2327 is not a mandatory clause. Other clauses in the FAR have prescriptive provisions without this type of qualifying language. Moreover, I do not see any significant or deeply ingrained strand of public procurement policy at issue in this case.

Second, I conclude that if it had been included, FAR 52.232-7 would not have prohibited the 4% fee for subcontract oversight paid to Hill under the Contract. FAR 52.232-7 prohibits payment of profit on "materials." The clause defines "materials" as "subcontracts for supplies and incidental services for which there is not a labor category specified in the contract." The construction subcontracts under the RAC prime contract are clearly not for supplies. Accordingly, in continuing to determine whether 52.232-7 is applicable, one must ascertain whether the construction subcontracts are "incidental services" to the RAC prime contract; I conclude that they are not.

In support of its position, the OIG relies on Black's Law Dictionary which defines "incidental" as "subordinate to something of greater importance; having a minor role." The OIG concludes that because subcontracts are "subordinate to" prime contracts, they meet FAR 52.232-7's definition of "incidental services." OIG Memorandum, December 18, 2013, page 3, ¶ 2. This argument is without merit. It would lead to the conclusion that every subcontract for services under all of the prime contracts across the entire Federal government are "incidental." Further, I do not believe that the term "incidental services" can be defined in a task-oriented vacuum; one must look at the broad context of the work being performed under a contract to ascertain whether a task or activity accomplished thereunder is considered "incidental" to the contract as opposed to being one of the primary purposes of the contract. This leads me to examine the actual language of the contract in question.

An examination of the Contract reveals that the primary work to be performed is: (1) A/E services (remedial design) by the prime contractor (Hill) and; (2) construction work (remedial action, i.e., implementation of the design) by subcontractors. For example, the expected outcomes and deliverables for fund-lead site specific work areas under the subject contract are defined, in relevant part, as follows:

> Remedial Design
>
> Convert the remedy selected in the Record of Decision (ROD) into a final design document for the Remedial Action (RA). All activities shall be in conformance with the remedy selected and set forth in the ROD, or otherwise directed by EPA.
>
> Expected outcomes and deliverables:
>
> 1. Design Criteria/Conceptual (Preliminary) Design
> 2. Intermediate Design
> 3. Pre-final/Final Design (including cost estimate)
>
> Remedial Action
>
> Implement the design remedy through the procurement of a construction subcontractor(s), construction management activities, and technical and field engineering services, in accordance with the objectives of the Remedial design.
>
> Expected outcomes and deliverables:

1. Construction completion and/or implementation of remedy

2. Remedial Action report

Reference: Contract No. EP-S9-08-04, Attachment 1, SOW, pages 1-5 to 1-6.

In light of the above, it is readily apparent that the RAC contract was bifurcated between design work performed by the prime contractor and implementation (construction) work performed by subcontractors. Approximately $38 million of the $110 million spent under the subject contract (34.5%) was for subcontracted services. Contrary to the OIG's assertions, I do not believe that one third is indicative of an incidental or minor role. It is also important to note that the Agency's future Superfund remediation contracts will separate design and construction requirements into separate contracts eliminating the need for bifurcation as seen in this older contract vehicle.

In further examination of the contract, the term "incidental services" is specifically addressed in Attachment 13 to the prime contract, "Clarifications on Program Management Factor (PMF)," at 13-1 to 13-6. Attachment 13 includes a matrix of "incidental services" for which the prime contractor is prohibited from charging a profit. These "incidental services," for which no labor category is specified, include myriad tasks that are tangentially related to the primary task of Hill's contract with EPA, i.e., remedial design work. They include, for example, conducting background checks on employees; medical examinations and monitoring services; and service and maintenance of vehicles and equipment. Markedly absent from Attachment 13 is any reference to oversight of subcontracted construction activities.

The OIG asserts that contract Clause B.5(d) supports the premise that the questioned subcontract construction oversight costs meet FAR 52.232-7's definition of "incidental services", because other activities listed in Clause B.5(d) are examples of services incidental to A-E work. The mere fact that "construction activities" are included on a list that also contains activities that one might consider incidental does not make "construction activities" incidental. The Contracting Officer has indicated that Clause B.5(d) is an administrative clause intended to address the segregation of non-team subcontracting costs and that it was not meant to, nor does it, define "incidental services." As discussed above, "incidental services" are addressed in Attachment 13 of the contract and oversight of subcontractor construction work is not included.

Finally, I must address conclusions reached in the OIG's June 5, 2014 memorandum which states, in pertinent part, the following:

> Hence, the contracting officer's real intent is in question. An additional problem with the resort to 'intent' relates to the agency position that the profit on materials paid to the prime contractor was needed to offset additional risk encountered in a construction management/oversight contract. This appears to be factually incorrect because the government actually bears all the risk in a time and materials contract given that it is paying for all charged management/oversight. The 4 percent profit on materials – not only violated the Federal Acquisition Regulation (FAR) – it was not justified. OIG Memorandum to Bob Perciasepe, June 5, 2014, page 1, ¶ 2.

First, the Contracting Officer's intent is clear to me. Because of the contract's bifurcated structure, i.e., remedial design and remedial implementation, and the concomitant necessity to avoid any conflicts of interest during performance, the Agency required the RAC prime contractor to subcontract all construction work, yet, retain overall responsibility and liability for overseeing this complicated work. Accordingly, the Contracting Officer negotiated a four percent (4%) fee (significantly, less than the ten percent (10 %) requested by Hill in pre-award negotiations) to be applied to the cost of subcontract construction oversight. Rather than incorporate subcontract construction oversight costs into Hill's fixed rate, regardless of whether the work was for subcontract construction oversight or A&E work performed directly by Hill, the four percent (4%) fee was applied to the total of subcontracted costs, thereby compensating Hill only for the additional work associated with subcontract construction oversight. Not only was the Contracting Officer's negotiation a course of action that ultimately saved the Agency money, it was also in conformance with Agency regulations, specifically EPAAR 1515.404-471 (EPA Structured Approach for Developing Profit or Fee Objectives).

Second, contrary to the OIG's assertion in its June 5, 2014 memorandum, the government does not bear "all the risk" in a time-and-materials contract. The assumption of risk in the government contract arena is essentially a continuum; it is not an "all or nothing" scenario. There is certainly less risk for the government in a firm-fixed price contract than in a time-and-materials contract, but the contractor still bears some element of risk in a time-and-materials contract. For example, the contractor assumes the risk for: overall program management outcomes; performance of individual tasks (because improperly completed work is remedied at the contractor's expense); and potential variability in labor and fixed-costs.

The subject contract was no different. In accordance with Section B.5(b) of the contract, all the subcontracts subject to the additional four percent (4%) fee were required to be either fixed-price or performance based, with the overwhelming majority ultimately being fixed-price. Under a fixed price contract, the majority of the performance risk is shifted to the contractor. While the rest of the RAC may have been primarily time-and-materials based, the piece eligible for the additional four percent (4%) fee, construction oversight, was primarily comprised of services that were fixed price. Thus, the additional profit in question was only provided to compensate the prime contractor for the additional inherent performance risk associated with the fixed-price construction subcontracts (fixed price construction work has some of the highest performance risk of all fixed price contracts due to bonding requirements, subcontractor performance issues, health and safety concerns, and insurance liabilities).

In light of the above, I find that the OIG has not demonstrated that FAR 52.232-7 was required to be in Contract No. EP-S9-08-04 nor has the OIG demonstrated that the Agency's payment of a fee, or profit, to Hill for oversight of subcontracted construction work was improper. Consequently, I find no merit to the OIG's assertion that the Agency should seek reimbursement of monies paid to Hill for work performed, accepted, and paid for.

ATTACHMENT A

The Contract

The Contract is a fixed rate, indefinite delivery/indefinite quantity, time and materials type contract. The base period of the contract is a three (3) year period with award terms for up to an additional seven (7) years of performance. The EPA exercised the first award term and extended performance to September 23, 2013. To date, the EPA has reached the contract ceiling of $116.25 million, and no new task orders will be issued. The contract, however, will continue until completion of projects awarded under existing task orders. No new work beyond the scope of the original task orders will be ordered nor will the contract ceiling be extended beyond the time needed to complete existing task order requirements.

In order to avoid a conflict of interest in the two stage RAC design/build process, EPA requires a RAC prime contractor, who designs the remedy for a site, to subcontract all of the construction work at that site. In accordance with the contract, however, the prime contractor retains overall responsibility and liability for the subcontracted construction work; this, in turn, results in subcontract construction oversight costs. Accordingly, pursuant to Environmental Protection Agency Acquisition Regulation (EPAAR) 1515.404-71 (EPA Structured Approach for Developing Profit or Fee Objectives), the Contracting Officer negotiated a separate four percent (4%) "premium" or fee to compensate Hill for these subcontract construction oversight costs. In short, rather than incorporate subcontract construction oversight costs into Hill's overall fixed rate, regardless of whether the work was for subcontract construction oversight or A&E work performed directly by Hill, the four percent (4%) premium was applied to the total of subcontracted costs, thereby compensating Hill only for the additional work associated with subcontract construction oversight.