Price Realism Analysis: An Examination of an Area Ripe for Reform

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Disclaimer

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Abstract

Price Realism Analysis: Examination of an Area Ripe for Reform

The purpose of this thesis is to explore the confusion and misapplication of price realism analysis in evaluations of firm-fixed price contracts and to make recommendations to generate a more straightforward process. It undertakes an examination of the relevant regulations, case law, scholarly articles, and approach to realism analysis taken by the international procurement community in order to demonstrate that revisions to the current regulations are long overdue. The overarching message is that FAR Part 15 needs to be revised to clarify the purpose and process for performing a price realism analysis. Simple revisions to the FAR, including placing cost realism and price realism analysis in two different sections and explaining how price realism is different than price reasonableness, would clear up a great deal of confusion and would result in fewer sustained protests in this area. Furthermore, these revisions would provide the government with a valuable tool to ensure that only offerors who can perform for the price proposed are awarded firm-fixed price contracts. Price realism analysis enables the government to eliminate performance problems associated with offerors that cannot comply with the representations made in their proposals due to underbids.
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I. INTRODUCTION

A long-standing source of confusion in the area of proposal evaluation is how to perform a cost realism analysis on a fixed-price effort, or, as the GAO and courts refer to it, a price realism analysis. In theory, fixed-price contracts place much less burden on contract officials than cost-type contracts. When offerors submit price proposals for fixed-price efforts, the proposed prices are not subject to adjustment, and the agency does not have to perform an analysis of the individual cost elements of a fixed-price proposal. Accordingly, it would seem that protests in the area of price evaluation would be few and far between, but because the acquisition regulations are so ambiguous in the area of realism analysis on fixed-price efforts, contracting officials frequently trip over this area of the price evaluation. This confusion has resulted in a relatively high number of sustained protests.

Price realism analysis, while confusing in the form currently presented in the regulations, can be a valuable tool when used correctly. While fixed-price contracts shift risk and responsibility for all potential loss to the contractor instead of the government, there is still risk to the government that a contractor that bids too low will not be able to successfully complete the contract. The results of a price realism analysis are useful in that they illustrate whether an offeror grasps the magnitude of the effort that will be required of it during performance. If it is clear from the results of the evaluation that the offeror does not fully understand the requirements, the government can eliminate it from the competition and make award to an offeror that will be able to perform without the risk of failing financially.
This thesis offers recommendations for improving the regulations that address how to perform a price realism analysis. Section II outlines the roots and evolution of realism analysis on fixed-price efforts. Section III explores a recent line of cases from the GAO, the Court of Federal Claims, and the Court of Appeals for the Federal Circuit on price realism analysis. Section IV discusses some of the most frequent issues encountered in price realism protests and also explores some decisions in the area of cost realism analysis. Section V explores whether price realism analysis is even necessary and the form that a realism analysis should take. Section VI presents a comparative analysis of how the international procurement community addresses unrealistically low prices. Finally, Section VII presents recommendations for improving the regulations to make performance of price realism analysis understandable to contracting officials. The thesis concludes that serious revisions are necessary to isolate price realism analysis from cost analysis. This should result in a reduced number of sustained protests in this area.

II. ORIGINS OF REALISM ANALYSIS

The roots of realism analysis can be found in the mistake rules relating to sealed bidding. Under the FAR rules for sealed bidding competitions, the contracting officer must examine submitted bids for apparent mistakes before awarding the contract.\(^1\) The contracting officer is permitted to correct obvious mistakes, such as misplaced decimal points and mathematical errors, after verifying with the contractor that the error was unintentional.\(^2\) But, for mistakes that are not clerical in nature, a complex set of rules has evolved to balance the government’s desire to award to a low-cost bidder against the

\(^{1}\) FAR 14.407-1.

\(^{2}\) FAR 14.407-2(a).
danger involved in awarding to an offeror that cannot perform at the proposed price.\(^3\)

The policy behind these rules for sealed bidding is straightforward: if a contractor bids too low out of a lack of understanding of the requirements or a lack of experience, it would not be in the government’s interest to take advantage of the low price because inevitably, the contractor will falter during performance and the government will have expended funds on a requirement that will have to be fulfilled through other means.

**A. HOW TREATMENT OF REALISM ANALYSIS IN THE REGULATIONS HAS EVOLVED**

The FAR’s discussion of cost realism has never been especially instructive, despite decades of calls for rewrite to make the treatment of cost realism more easily understood.\(^4\) While early versions of the regulations did not provide specific guidance on performing realism analysis, they did succinctly and accurately state the purpose for performing a realism analysis: early versions of the regulations simply stated that for cost-reimbursement contracts, the cost proposal should not be controlling since this would encourage “submission of unrealistically low estimates and increase the likelihood

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\(^3\) FAR Subpart 14.407-3 contains a complex set of instructions for dealing with bids that contain a mistake.

\(^4\) Ralph C. Nash, Jr. & John Cibinic, Jr., *Cost Realism Analysis in Negotiated Fixed Price Contracts: Confusion at the GAO or a New Limitation on Buy-Ins?* 4 NASH & CIBINIC REP. ¶ 61 (Oct. 1990). John Cibinic called for a rewrite of the regulations governing cost realism analysis:

We also believe that the regulations dealing with cost realism analysis are in need of major work. They should require that all fixed price contracts be subject to cost realism analysis. Award of a contract at an unrealistically low price should only be made with a knowledge of the risks involved. In addition, the regulations should make clear the differing purposes of cost realism analyses for cost reimbursement and fixed price contracts. *Id.*
of cost overruns.”5 The need for further guidance was obvious – confusion over how to perform a proper realism analysis resulted in a significant number of sustained protests, both on firm-fixed price and cost-reimbursement contracts.6

B. THE CURRENT REGULATIONS ON COST REALISM

The current version of the FAR addresses cost realism analysis under FAR 15.404-1, Proposal analysis techniques. Cost realism analysis must be performed on all cost-reimbursement contracts.7 It is defined as “the process of independently reviewing and evaluating specific elements of each offeror’s proposed cost estimate to determine whether the estimated proposed cost elements are realistic for the work to be performed; reflect a clear understanding of the requirements; and are consistent with the unique methods of performance and materials described in the offeror’s technical proposal.”8

5 48 C.F.R. 15.605(d) (1990). This explanation was deleted during the FAR Part 15 Rewrite because the FAR Council wanted to broaden the definition of cost realism. Jerome S. Gabig, Jr., FAR Part 15 Rewrite – A Lost Opportunity to Reduce the Confusion Involving Cost Realism, 12 NASH & CIBINIC REP. ¶ 16 (Mar. 1998).


For example, a study of Comptroller General decisions indicates that a protest which alleges that an agency has not correctly performed a cost realism analysis had a 345% better chance of being sustained than a protest which alleges that an agency did not engage in meaningful discussions.

Id.

7 FAR 15.404-1(d)(2).

8 FAR 15.404-1(d)(1). “Cost realism analysis is undertaken to determine whether the estimated proposed cost elements are realistic for the work to be performed, reflect a clear understanding of the requirements, and are consistent with the offeror’s technical proposal.” Karen L. Manos, GOVERNMENT CONTRACT COSTS & PRICING § 84:22 (2011).
The FAR dictates that cost realism analysis “shall be performed on cost-reimbursement contracts to determine the probable cost of performance for each offeror.”\(^9\) This means that agencies are required to develop a most probable cost of performance for each offeror proposing on a cost-reimbursement effort; development of the most probable cost is not discretionary.\(^{10}\)

The purpose of developing a most probable cost is to identify those offerors that provide unrealistically low cost estimates since actual, allowable costs under a cost-reimbursement contract will be reimbursed by the government.\(^{11}\) This bidding technique would provide those offerors with an unfair advantage, so by developing a most probable cost for each offeror, the government is able to adjust offerors’ costs accordingly and provide for a level playing field.\(^{12}\) The most probable cost is developed by adjusting the offeror’s proposed price in accordance with the findings of the realism analysis.\(^{13}\) The most probable cost must be developed based on an evaluation of the elements of the price proposal in conjunction with an evaluation of the offeror’s proposed approach from its technical evaluation. The agency then adjusts the offeror’s proposed price based on what it considers to be the true costs of performance. This adjusted price serves as the evaluated price for the competition.

\(^9\) FAR 15.404-1(d)(2).

\(^{10}\) FAR 15.404-1(d)(2).

\(^{11}\) In cost-reimbursement contracts, estimated costs of performance are not definitive since “advance estimates of cost may not provide valid indicators of final actual costs.” Prospere S. Virden, Jr. and James P. Gallatin, Jr., Buying-In, 84-3 BRIEFING PAPERS 1, 4 (March 1984).

\(^{12}\) See Nash & Cibinic, supra note 4.

\(^{13}\) FAR 15.404-1(d)(2)(ii).
C. WHAT IS PRICE REALISM ANALYSIS?

Interestingly, “cost realism” analysis for fixed price efforts is addressed in the same subsection of the FAR as cost realism analysis, even though the two analyses bear little resemblance to one another. To eliminate some of the confusion surrounding cost realism analysis for fixed price efforts, commentators began referring to this type of analysis as “price realism”; however, this term does not exist in the FAR.\textsuperscript{14} The FAR limits application of price realism analysis to competitive fixed-price incentive contracts and other competitive fixed-price-type contracts when “new requirements may not be fully understood by competing offerors, there are quality concerns, or past experience indicates that contractors proposed costs have resulted in quality or service shortfalls.”\textsuperscript{15} The only guidance provided by the FAR on how to use the results of the price realism analysis is that “[r]esults of the analysis may be used in performance risk assessments and responsibility determinations.”\textsuperscript{16}

Unlike cost-reimbursement efforts, where an offeror may underbid on purpose to win the contract and plans to recoup any additional funds expended, for fixed-price efforts, underbids are (at least in theory) confined to two circumstances: buy-in,\textsuperscript{17} when

\begin{itemize}
\item \textsuperscript{14} Ralph C. Nash, Jr. & John Cibinic, Jr., Price Realism Analysis: A Tricky Issue, 12 NASH & CIBINIC REP. ¶ 40 (July 1998).
\item \textsuperscript{15} FAR 15.404-1(d)(3).
\item \textsuperscript{16} Id.
\item \textsuperscript{17} See FAR Subpart 3.5. Buy-in is legal and is already addressed in the FAR. FAR Subpart 3.5 defines “buying-in” as “submitting an offer below anticipated costs, expecting to – (1) increase the contract amount after award (e.g., through unnecessary or excessively priced change orders); or (2) receive follow-on contracts at artificially high prices to recover losses incurred on the buy-in contract.” FAR 3.501-2 provides
\end{itemize}
the offeror bids low on purpose for various reasons, such as intentionally taking a loss to
gain a foot-hold in the market or attempting to recover losses during performance through
change orders, and through mistake, where the offeror bids low because it does not
understand the technical requirements.18 Development of the most probable cost is the
touchstone of a cost realism analysis, but for a realism analysis on a fixed price effort, no
most probable cost is developed.19 In fact, the FAR explicitly prohibits adjusting offered
fixed prices as a result of the realism analysis.20 Rather, the agency uses the realism
analysis as a subset of other source selection criteria in the solicitation to address quality
concerns and to determine whether the offeror understands the requirements.21 The
offeror’s technical rating is then downgraded if the agency determines that the proposed
price is unrealistic.22

Examples of ways in which price realism analysis are used include evaluating
whether an offeror has proposed inadequate staffing, has proposed rates that will enable

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guidelines for contracting officers to safeguard against buy-ins, including using multiyear
contracting and priced options for additional quantities.

18 See Nash & Cibinic, supra note 4.

19 FAR 15.404-1(d)(3).

20 Id. “Results of the analysis may be used in performance risk assessments and
responsibility determinations. However, proposals shall be evaluated using the criteria in
the solicitation, and the offered prices shall not be adjusted as a result of the analysis.”

Id.

21 See CSE Construction, B-291268.2, December 16, 2002, 2002 CPD ¶ 207, at 4 (citing

22 Agencies may not downgrade or adjust a fixed-price proposal “simply by virtue of its
low price.” Marshall J. Doke, Jr., Miki Shager, 2000 Procurement Review, 01-02
BRIEFING PAPERS 1, 6 (January 2001).
the contractor to attract and retain employees, or has submitted a price proposal that is inconsistent with its technical proposal. The form that price realism analysis can take varies according to the particular acquisition, but generally it involves evaluating whether the technical approach matches the price proposal, comparing the proposed price to the independent government cost estimate, comparing the offeror’s proposed prices to actual costs on previous contracts, and/or reviewing individual direct and indirect costs to determine whether the offeror can provide the supply or service for the price proposed.

Cost realism analysis is performed as an element of the overall cost evaluation: the most probable cost is calculated to demonstrate which offeror represents the best value to the government. Price realism analysis should take place as part of the responsibility determination or as part of the technical or risk evaluation. As part of a technical evaluation, it is generally included as part of an “understanding of the requirement” evaluation factor or as a performance risk factor. If is not incorporated as part of the

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25 See Gabig, *supra* note 5.


technical or risk evaluation, price realism should be evaluated as part of the overall responsibility determination.  

D. EFFORTS TO IMPROVE THE REGULATIONS

The FAR Council has attempted to redefine cost realism analysis, but these efforts have only resulted in further confusion. The bare-bones explanation of the purpose of realism analysis at FAR Subpart 15.6 remained the only reference to realism analysis in the regulations until 1997, when the realism discussion was expanded and moved to FAR 15.404, Proposal Analysis. This change came as a result of the FAR Part 15 Rewrite, when the FAR Council attempted to add guidance on realism analysis to the FAR.  

Professors Ralph Nash and John Cibinic characterized the FAR Part 15 Rewrite as a squandered opportunity to clear up the confusion over realism. The American Bar Association (ABA) Section of Public Contract Law (Section) submitted a letter to the FAR Secretariat on July 14, 1997 calling for several changes to the newest version of

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29 Gabig, supra note 5. The FAR Part 15 rewrite, which took effect on October 10, 1997, became mandatory for all solicitations on January 1, 1998 and was undertaken by the FAR Council in order to “infuse innovative techniques into the source selection process, simply the process, and facilitate the acquisition of best value.” 62 Fed. Reg. 51,224 (Sept. 30, 1997).

30 Nash & Cibinic, supra note 4.

The “major work” suggested by John in 1990 was drafted by the Public Contract Law Section of the American Bar Association and submitted as part of its comments to the May 14, 1997 version of the FAR Part 15 Rewrite. Just as John was ignored in 1990, so too the much needed ‘major work’ was ignored by the ad hoc interagency committee in promulgating the final FAR Part 15 Rewrite.

Id. Nash and Cibinic also point to the FAR’s failure to differentiate between price and cost realism as a major defect. Id.
The Section applauded the FAR Council for its decision to add meaningful discussion of cost realism to the FAR, but criticized the omission of the statement of why cost realism should be performed on cost-reimbursement-type contracts. The Section also noted the Council’s failure to differentiate between cost realism and price realism. As the Section pointed out, cost realism and price realism are “fundamentally different” since the contractor, not the government, bears the consequences of a cost overrun on a firm-fixed price contract. The Section recommended adding the following definition of price realism analysis: “Price realism analysis is a means by which the government protects itself from the risk of poor performance where an offeror would incur a financial loss to properly perform the contract because its proposed price is unreasonably low.” The Section suggested making cost realism analysis a subset of cost analysis and

31 Letter from the Section of Public Contract Law of the American Bar Association to the General Services Administration FAR Secretariat (July 14, 1997) (on file with author) [hereinafter “ABA Section letter”].

32 Id.

33 Id.

34 Id.

35 Id.

36 ABA Section Letter at 4. The Section suggested adding the following language to address cost realism analysis to FAR 15.504-1(c):

(3) Cost realism analysis.

(i) Cost realism analysis is a process of independently reviewing and evaluating specific elements of an offeror’s cost proposal to ascertain whether the offeror submitted unrealistically low estimates.

(ii) In awarding a cost-reimbursement contract, the cost proposal should not be controlling, since advance estimates of cost may not be valid indicators of final actual costs. There is no requirement that cost-reimbursement contracts be awarded on the basis of lowest proposed cost, lowest proposed fee, or lowest total proposed cost plus fee. The award of cost-reimbursement contracts primarily on
making price realism analysis a subset of price analysis. The Section also suggested adding the following language to the clause at FAR 52.215-1(f)(9): “If a price realism

the basis of estimated costs may encourage the submission of unrealistically low estimates and increase the likelihood of cost overruns.

(iii) Cost realism analyses shall be performed on competitive cost-reimbursement contracts to determine the probable costs of performance for each offeror. Cost realism analyses may be performed on non-competitive cost-reimbursement contracts.

(iv) A probable cost should reflect the Government’s best estimate of the cost to the Government that is most likely to result from an offeror’s proposal. Where the probable cost differs from the offeror’s proposed cost, the probable cost shall be considered in making the source selection decision.

(v) Although not part of the cost realism analysis, nothing in this subpart prohibits technical evaluators, from reviewing an offeror’s allocation of financial resources in its cost proposal, to gain insight into whether the offeror understands the complexity and magnitude of the requirements. Id.

ABA Section Letter at 4-5. The Section suggested adding the following language to address price realism analysis to FAR 15.504-1(b):

3) Price realism analysis.

(i) Price realism analysis is a process of independently reviewing and evaluating specific elements of an offeror’s price proposal to ascertain whether the offeror submitted unrealistically low prices for the work to be performed. If necessary, cost analysis may be used on specific elements of a price proposal.

(ii) Price realism analysis should be performed on any fixed price contract in which the contracting officer perceives a risk of poor performance if the offeror were to incur a financial loss to properly perform the contract, because the offeror’s proposed price is unrealistically low.

(iii) Where the probable price is significantly higher than the proposed price, the contracting officer should seek to ascertain whether the offeror is buying in. See FAR Subpart 3.5.

(iv) Regardless of whether the offeror is buying in, the source selection authority may consider the results of the price realism analysis in making the source selection decision.

(v) Although not part of the price realism analysis, nothing in this subpart prohibits technical evaluators from reviewing the offeror’s allocation of financial resources in its price proposal, to gain insight into whether the offeror understands the complexity and magnitude of the requirements.

Id.
analysis is performed, price realism may be considered by the source selection authority in evaluating performance or schedule risk.”\textsuperscript{38}

Ultimately the Section’s suggested revisions were not incorporated, and the committee drafting the FAR Part 15 rewrite opted to include the broad statements on realism that are in the current version of the FAR. The committee also ignored the Section’s suggestion to put cost realism and price realism under different subparts in order to clear up the confusion between the two types of analyses. The Part 15 rewrite could have cleared up the confusion over realism analysis, but unfortunately it was a missed opportunity.

Agency-specific FAR supplements and guides also fail to provide useful information to contracting officers. The most comprehensive guidance comes in the form of the Department of Defense five-volume set of reference guides for use by acquisition personnel and price evaluators developed by the Federal Procurement Institute in conjunction with the Air Force Institute of Technology; however, the Guides fall short of providing useful direction when it comes to price realism.\textsuperscript{39} Cost and price realism analysis are covered in Chapter 8 of the Advanced Issues in Contract Pricing volume, entitled “Conducting Cost Realism Analyses.” The guide goes into great detail on when cost realism analysis is appropriate, the process of performing cost realism analysis, what is necessary to perform cost realism analysis, the role of various personnel in performing

\textsuperscript{38} Id.

cost realism analysis, and determining whether development of a most probable cost is necessary.\textsuperscript{40} The Guide also lists various questions that personnel performing cost realism analysis should ask.\textsuperscript{41} The Guide includes a lengthy section on considering the effect of uncompensated overtime on cost realism.\textsuperscript{42} When it comes to price realism analysis, however, the Guide merely restates the guidance in the FAR and provides a few examples of GAO decisions.\textsuperscript{43}

III. JUDICIAL AND ADMINISTRATIVE TREATMENT OF REALISM ANALYSIS: THE KC-135 PDM LINE OF CASES

Because the guidance available to contracting officers on how to perform a price realism analysis is sparse at best, the courts and the GAO have struggled with consistent application of the rules. While in most cases the agency has a fair amount of discretion to determine the form of its realism analysis, occasionally the courts and the GAO issue decisions questioning the nature and extent of the evaluation. This has resulted in a body of case law on the topic that only muddles an already enigmatic area of proposal evaluation. This confusion is especially apparent in the line of cases issued by the GAO, the Court of Federal Claims, and the U.S. Court of Appeals for the Federal Circuit in 2007-2009 on the contract to perform maintenance of the Air Force’s KC-135 aircraft. In this line of decisions, the GAO initially ruled against the agency, finding that the agency

\begin{footnotesize}
\begin{enumerate}
\item \textit{Id.} at 7-8.
\item \textit{Id.} at 8-9.
\item \textit{Id.} at 11-12.
\item The Guide lists situations in which the agency may want to use price realism analysis, such as to assess performance risk, technical understanding, and responsibility. The rest of the guidance on price realism is limited to examples from GAO case law.
\end{enumerate}
\end{footnotesize}
failed to adequately document its decision that a price cut by the awardee during discussions was reasonable. The GAO reversed its decision and found for the agency following corrective action. The Court of Federal Claims then reversed the GAO decision and found that the agency’s price realism analysis was arbitrary and capricious. Finally, the Federal Circuit reversed the Court of Federal Claims and concluded that the agency’s findings were justified. This judicial disorientation captures the lack of understanding of price realism analysis.

A. THE KC-135 PDM SOLICITATION

The solicitation to provide programmed depot maintenance (PDM) of the Air Force’s fleet of KC-135 aircraft on a firm-fixed price basis was first issued in August 2005. The KC-135 PDM solicitation provided for a competitive, best value source selection and stated that the government sought to award to the offeror which would give the Air Force the greatest confidence that it could meet the requirements affordably.\(^{44}\) The evaluation process was described as an “integrated assessment of the evaluation factors and subfactors.”\(^{45}\) Offerors were advised that the Source Selection Authority (SSA) could make award to a higher rated, higher priced offeror where the decision was consistent with the evaluation factors and SSA reasonably determined that “the technical superiority and/or overall business approach, and/or superior past performance, of the higher priced offeror outweighs the cost difference.”\(^{46}\) Offerors were instructed to submit a Mission Capability and Proposal Risk volume, a Cost/Price volume, and a Past

\(^{44}\) C/KC-135 RFP at 80 (on file with the author).

\(^{45}\) Id. at 81.

\(^{46}\) Id. at 80.
Performance volume. The Mission Capability subfactors were Depot Maintenance, Supply Chain Management, Transition, Program Management, and Small Business. The solicitation advised that mission capability, proposal risk, and past performance were of equal importance, and when combined were significantly more important than cost/price.\textsuperscript{48}

Section L instructed offerors to submit information other than cost or pricing data in accordance with FAR 15.403-5 to support price reasonableness and cost realism, and advised that offerors might be required to submit cost or pricing data if the Contracting Officer lacked sufficient information to make a reasonableness determination.\textsuperscript{49} Section M provided that the government could reject any proposal that was “evaluated to be unrealistic in terms of program commitments, including contract terms and conditions, or unrealistically high or low cost/price when compared to government estimates, such that the proposal is deemed to reflect an inherent lack of competence or failure to comprehend the complexity of risks of the program.”\textsuperscript{50} Section M outlined the procedures for evaluation of the Cost/Price factor and outlined the CLIN structure for the base and four option years.\textsuperscript{51} Offerors were instructed to provide a firm-fixed price amount for a base

\textsuperscript{47} Id. at 63.

\textsuperscript{48} Id. at 79. The solicitation provided for ratings of Blue/Exceptional, Green/Acceptable, Yellow/Marginal, and Red/Unacceptable. Id. at 80.

\textsuperscript{49} Id. at 64.

\textsuperscript{50} Id. at 81.

\textsuperscript{51} Id. at 86-88.
period of four years and one month, plus five one-year option periods.52 Offerors were to price the Best Estimated Quantity (BEQ) of KC-135 aircraft to be provided by the government and to price an Over and Above (O+A) Labor CLIN.53 For the O&A CLIN, the government provided an estimated quantity of hours and estimated O&A parts and materials and instructed offerors to provide fixed hourly rates.54 Section M again cautioned offerors that “[u]nrealistically low proposed prices, initially or subsequently, may be grounds for eliminating a proposal from competition either on the basis that the Offeror does not understand the requirement or the Offeror has made unrealistic [sic] proposal.”55

B. EVALUATION AND AWARD

The Boeing Company (“Boeing”) and Pemco Aeroplex, Inc. (“Pemco”) were incumbent contractors on the KC-135 PDM contract; Boeing was the prime contractor and Pemco performed maintenance as a subcontractor to Boeing.56 When proposals were

52 Id. at 84.

53 Id. at 78.

54 Prior to commencing any O&A work, the contractor was required to seek the government’s approval. The government and the contractor would then negotiate an appropriate amount for the O&A work. Addendum 1 to the solicitation provided that “[t]he Contractor shall promptly submit to the ACO [Administrative Contracting Officer] a Work Request for O&A work. The Government and the Contractor will then negotiate a settlement for the O&A work. Contract modifications will be executed to definitize all O&A work.” RFP Addendum 1 at 1. With regard to determining a settlement amount for O&A work, Addendum 1 instructed that “the price negotiated by the ACO shall be based on ‘hands on’ labor hours multiplied by the contract hourly rate. The number of ‘hands on’ labor hours required, shall be negotiated by the Contractor and ACO.” Id. at 2.

55 Id. at 88.

submitted in October of 2005, Pemco and Boeing proposed to perform this contract under the same arrangement as the previous contract.\textsuperscript{57} In May 2006, however, the Air Force amended the solicitation, reducing the estimated number of aircraft due to increases in the number of KC-135 aircraft that would be maintained by an organic workforce at Tinker Air Force Base.\textsuperscript{58} Based upon the reduced best-estimated quantity (BEQ) of KC-135 aircraft maintained under the new contract, Boeing severed its relationship with Pemco.\textsuperscript{59}

Pemco filed an agency-level protest on the grounds that the solicitation should be reopened following the amendment.\textsuperscript{60} In response to this protest the Air Force reopened the solicitation to allow for new proposals, and extended the due date for receipt of proposals to June 22, 2007.\textsuperscript{61} Pemco, Boeing, and Lockheed Martin all submitted proposals.\textsuperscript{62}

Following discussions and submission of final proposal revisions (FPRs), the SSA made his award decision and the Air Force awarded the contract on September 10,

\textsuperscript{57} Id.

\textsuperscript{58} Alabama Aircraft Industries, Inc.-Birmingham v. U.S., 83 Fed.Cl. 666 at 671 (Oct. 7, 2008). The Air Force issued an amendment to the solicitation on May 31, 2006 reducing the BEQ of KC-135 tankers to six aircraft in the first year and 25 in the remaining years of the contract. In June of 2006, the Air Force issued another solicitation amendment reducing the BEQ from 60 aircraft to 48. Id.

\textsuperscript{59} Id.

\textsuperscript{60} Id.

\textsuperscript{61} Id.

\textsuperscript{62} Id.
2007. The SSA concluded that while Pemco’s proposal was superior with regard to Past Performance, Boeing’s superior Mission Capability rating and overall lower total evaluated price (TEP) outweighed the benefits of Pemco’s higher Past Performance rating.

C. GAO DECISION I

Pemco protested the award at the Government Accountability Office (GAO) on the grounds that the Air Force performed a flawed past performance evaluation, performed a flawed mission capability evaluation, and performed a flawed price realism analysis. The GAO denied all of Pemco’s protest grounds except its allegation that the Air Force performed a flawed price realism analysis in a decision issued on December 27, 2007.

Specifically, Pemco alleged that the Air Force failed to assess a price drop that appeared in Boeing’s FPR. The drop in price was greater than the difference between the two offerors’ total evaluated prices and resulted in Boeing displacing Pemco as the lowest-priced offeror. A key concept of each offeror’s proposal involved application of “lean” programs to the PDM process to reflect efficiencies learned through repetition of

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63 Id. at 675.
64 B-310372 at 4.
65 Id. at 1.
66 Id.
67 Id. at 8.
68 Id.
the work as performance continued, and both offerors utilized a learning curve that factored into Boeing’s price drop at FPR.\(^{69}\)

During discussions, Boeing attributed its drop in price in its FPR to implementation of a lean program termed “Lean Cellular Maintenance System.”\(^{70}\) This drop in price was not attributable to any changes to Boeing’s technical approach.\(^{71}\) Boeing simply explained its decision as a business decision to assume the risk associated with the change.\(^{72}\)

In reaching its decision that the Air Force failed to account for the increased risk presented by Boeing’s reduction in the level of labor hours, the GAO relied upon a document entitled “Talking Paper on C/KC-135 PDM Recompetition Source Selection,” which stated that the Air Force expected increases in the volume of work required under the PDM aircraft due to the fact that the KC-135 fleet is aging.\(^{73}\) GAO interpreted this document, which was prepared for the Source Selection Evaluation Team (SSET) chair and KC-135 System Program Director but was not disclosed to offerors, as evidence that

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\(^{69}\) The Court of Federal Claims explained the Lean program as an attempt to “streamline the KC-135 PDM process and to eliminate wasteful and unnecessary steps, thus increasing the program’s efficiencies.” 83 Fed.Cl. at 672.

\(^{70}\) \textit{Id.} The GAO decisions are more heavily redacted than the Court of Federal Claims decision in terms of how Boeing was able to lower its proposed price at FPR. The Court of Federal Claims decision goes into detail on Boeing’s reduction in labor hours and its application of the learning curve, although all of the KC-135 PDM decisions are redacted as to the specifics of what Boeing’s learning curve looked like.

\(^{71}\) B-310372 at 8.

\(^{72}\) \textit{Id.}

\(^{73}\) 83 Fed.Cl. at 671.
the Air Force performed a defective realism analysis of Boeing’s proposal.\textsuperscript{74} The GAO found that the absence of any acknowledgement by the Air Force that allowing Boeing to reduce expended labor hours through the contract, despite the fact that the aging aircraft actually would demand expenditure of more labor hours, represented a fatal flaw to the source selection decision.\textsuperscript{75} As GAO stated, the lack of meaningful documentation addressing the “unexplained changes in Boeing’s assumptions between submission of its initial proposal and its subsequent proposal revisions” made it impossible for the GAO to determine if the agency was reasonable in its assessment that Boeing’s proposal was realistic.\textsuperscript{76}

As part of its recommendation to the agency, the GAO suggested that the Air Force perform and document a realism assessment of the impacts of Boeing’s changes at FPR and then make a new source selection decision.\textsuperscript{77} The Air Force undertook corrective action in the form of comparing the effort proposed by Boeing to the effort performed by the Air Force’s organic workforce performing similar work at Tinker Air Force Base, and analyzing Boeing’s ability to capture efficiencies on other aircraft programs.\textsuperscript{78} As a result of this evaluation, the Air Force concluded that Boeing’s changes

\begin{flushleft}
\textsuperscript{74} B-310372 at 9.
\textsuperscript{75} Id.
\textsuperscript{76} Id.
\textsuperscript{77} Id. at 12.
\end{flushleft}
at FPR were reasonable.\textsuperscript{79} The SSA made a new decision and again found that Boeing’s proposal represented the best value to the government.\textsuperscript{80}

D. GAO DECISION II

In its protest of the Air Force’s second award decision, Pemco alleged that the Air Force was required to reopen discussions with offerors and that the Air Force’s second price realism analysis was also flawed.\textsuperscript{81} The GAO denied the discussions argument on the basis that it was reasonable for the Air Force to undertake corrective action in the form of re-documenting its evaluation since the first protest was upheld on the grounds of an “informational deficiency in the agency’s evaluation record.”\textsuperscript{82}

With regard to Pemco’s flawed price realism argument, the GAO rejected Pemco’s argument that the Air Force ignored relevant information in finding Boeing’s proposal realistic, such as Pemco’s proposal, Boeing’s initial proposal, and the internal government estimate (IGE).\textsuperscript{83} The GAO concluded that the analyses the Air Force undertook as part of corrective action were consistent with the solicitation.\textsuperscript{84} The GAO

\begin{enumerate}
\item Id.
\item Id. at 4.
\item Id.
\item Id.
\item Id. at 5.
\item The GAO held:
\begin{quote}
Although Pemco raises the full range of possibilities – that is, that the agency should not have considered certain information, that he agency should have considered certain other information, that the agency should have performed alternative analyses, and/or that the price realism and risk assessments should have been dispositively resolved by comparison to various benchmarks including
\end{quote}
\end{enumerate}
cited the principle that agencies have tremendous leeway in performing price realism and risk analyses to support its ruling in favor of the Air Force.\textsuperscript{85}

E. \hspace{1em} THE COURT OF FEDERAL CLAIMS DECISION

Following the GAO’s denial of its second protest, Pemco (now Alabama Aircraft Industries, Inc. (“AAII”))\textsuperscript{86} filed a complaint in the Court of Federal Claims on June 27, 2008.\textsuperscript{87} Judge Charles Lettow, the Court of Federal Claims judge who heard the case, found that AAII had standing to challenge the Air Force’s award of the KC-135 PDM contract even though Pemco had undergone a corporate restructuring.\textsuperscript{88} AAII’s challenges to the Boeing award involved the existence of an organizational conflict of interest, a flawed past performance evaluation, and a flawed price realism analysis.\textsuperscript{89}

Judge Lettow dismissed AAII’s challenges based on the organizational conflict of interest\textsuperscript{90} and the flawed past performance evaluation.\textsuperscript{91} The Court of Federal Claims

\begin{center}
\footnotesize
Pemco’s own proposal – its protest fails to demonstrate that any of the agency’s actions, inactions, or analyses are inconsistent with, or contrary to, the terms of the solicitation or applicable statute or regulation. \textit{Id.} at 6.
\end{center}

\textsuperscript{85} \textit{Id.}

\textsuperscript{86} 866 Fed. Cl. at 669. Pemco Aeroplex Inc.’s parent company, Pemco Aviation, undertook a corporate restructuring while the KC-135 PDM source selection was underway that involved selling Pemco Aeroplex’s sister corporation, Pemco World Air. The purchaser of Pemco World Air acquired the exclusive right to the Pemco name and the names of Pemco Aeroplex and Pemco Aviation were changed to Alabama Aircraft Industries, Inc. – Birmingham and Alabama Aircraft, respectively. \textit{Id.}

\textsuperscript{87} \textit{Id.} at 679.

\textsuperscript{88} \textit{Id.} at 685.

\textsuperscript{89} \textit{Id.} at 669.

\textsuperscript{90} \textit{Id.} at 685.
agreed with AAII’s challenge of the price realism analysis.\textsuperscript{92} At the Court of Federal Claims, AAII again focused its argument on the Air Force’s evaluation of Boeing’s application of its learning curve and the corresponding drop in its overall price.\textsuperscript{93} AAII again argued that this was inconsistent with the Air Force’s awareness of the aging KC-135 fleet and the Court of Federal Claims concurred.\textsuperscript{94}

Judge Lettow began his discussion with an overview of price realism analysis.\textsuperscript{95} Judge Lettow acknowledged that the agency has tremendous leeway in deciding the form its price realism analysis will take, but placed undue emphasis on the state of the aging KC-135 fleet and the fact that Boeing’s application of the learning curve caused its price

\textsuperscript{91} Id. at 690.

\textsuperscript{92} Id. at 700.

\textsuperscript{93} Id. at 695.

\textsuperscript{94} Id. at 696.

\textsuperscript{95} Id. at 696.

FAR lacks an explicit directive to contracting agencies mandating the use of any particular analytical tool in evaluating the reasonableness and realism of an offeror’s price. \textit{See} 48 C.F.R. § 15.404-1(b)-(e). In these circumstances, courts have according contracting agencies considerable leeway in evaluating price. \textit{See}, e.g., \textit{Honeywell, Inc. v. United States}, 870 F.2d 644, 648 (Fed.Cir.1989); \textit{International Outsourcing Servs. v. United States}, 69 Fed.Cl. 40, 48 (2005) (stating that ‘the nature and extent of an agency's price realism analysis are matters within the agency's discretion’) (citation omitted). However, that discretion can be abused. An agency's price-realism analysis lacks a rational basis if the contracting agency, for example, made ‘irrational assumptions or critical miscalculations.’ \textit{OMV Med., Inc. v. United States}, 219 F.3d 1337, 1344 (Fed.Cir.2000).

\textit{Id.}
to drop below that of AAII.96 The Court of Federal Claims faulted the Air Force for failing to conduct any new studies or to seek out new information in undertaking corrective action.97 The Court of Federal Claims decision cited to the external Air Force talking paper as evidence that the Air Force should have accounted for the aging fleet in evaluating Boeing’s proposal, and rejected the Air Force’s argument that Addendum 1 to the solicitation put offerors on notice that any changes to the contract in the out years would be negotiated as issues arose.98 Rather, the Court of Federal Claims found that the offerors did not understand that Addendum 1 meant that the issue of aging aircraft was “effectively taken off the table.”99 According to Judge Lettow, the O&A provisions were inadequate to address aging aircraft because “standard” PDM work increases would not be covered by O&A negotiations but would continue to fall under the basic PDM effort unless the tasks required 200 or more man hours to complete.100 Consequently, the Court of Federal Claims found that the Air Force’s price realism analysis was “arbitrary and

96 Id. at 697-98.

97 Id. at 698.

98 Id. at 699. The Court of Federal Claims characterized this arrangement as follows:

In effect, rather than awarding a firm fixed-price contract as the RFP envisioned, the Air Force’s subsequent statements indicate that this ‘fixed price’ contract was subject to continued contractual renegotiations because of aging aircraft and was at best a firm fixed-price contract only for the first year.

Id.

99 Id.

100 Id. at 700.
capricious” within the meaning of 5 U.S.C. 706(2)(A).  

"Failing in the first instance to deal explicitly with the aging-fleet issue in the RFP, as amended, and then seeking to sidestep the aging-fleet issue in the price-realism analysis of Boeing’s prevailing offer in this very close competition, renders the Air Force’s award to Boeing unsustainable.”  

F. THE FINAL WORD – DECISION FROM THE U.S. COURT OF APPEALS FOR THE FEDERAL CIRCUIT

The Federal Circuit issued its decision on the Air Force’s appeal on November 17, 2009. In a short decision, the Federal Circuit agreed with all aspects of the Court of Federal Claims decision except on the issue of price realism analysis. Where the Court of Federal Claims found that the Air Force failed to notify offerors that the issue of aging aircraft should not be a consideration, the Federal Circuit determined that the Air Force adequately addressed the issue through the work structure offerors were instructed to use in their proposals. The Federal Circuit found that the Court of Federal Claims decision went beyond the scope of what the lower court was permitted to consider, and substituted the lower court’s judgment for that of the agency when it attempted to inject the issue of aging aircraft into the solicitation. The Federal Circuit endorsed the agency’s method

101 Id.
102 Id.
103 Alabama Aircraft Industries, Inc.-Birmingham v. United States, 586 F.3d 1372 (Fed. Cir. 2009).
104 Id. at 1375.
105 Id.
106 Id. at 1376.
of addressing the aging aircraft issue through the three-tiered work package and found that this made sense given the unpredictable impact the aging KC-135 fleet would have on the PDM contract.\(^\text{107}\)

This line of decisions demonstrates that there is a state of confusion surrounding price realism analysis. Both the GAO and Court of Federal Claims exhibited confusion over where to draw the line to assess when the government has overstepped the discretion involved in making a realism analysis. These cases also demonstrate a further danger attributable to the lack of realism guidance in the FAR: the ambiguities in the process provide the opportunity for an overzealous judicial body to step in and shape a procurement when it feels an injustice has been perpetrated against an offeror. Because realism analysis is so ill-defined, courts can take the liberty of injecting their own interpretation of what a realism analysis should look like.

**IV. GAO AND COFC DECISIONS ON PRICE REALISM**

Confusion over price realism analysis is rampant throughout GAO and Court of Federal Claims decisions. The following cases demonstrate that this confusion is widespread throughout both the government and industry.

**A. REALISM v. REASONABLENESS**

Because of the way in which the FAR is currently drafted, contracting officers continually confuse price realism analysis with price reasonableness analysis. A price reasonableness determination is required for all acquisitions so that the contracting

\(^{107}\) *Id.* “As explained, the agency considered the aging aircraft issue, but because the impact on future requirements was unknown, it decided the best approach was to provide all offerors with the three-tier work package on which to base their proposals. This was a determination well within the agency’s discretion.” *Id.*
officer can determine that the final price is fair and reasonable.\textsuperscript{108} Reasonableness refers to whether a price is unreasonably high. Typically, adequate competition (which is defined in the FAR as “two or more responsible offerors, competing independently, submitting priced offers that satisfy the government’s expressed requirement”\textsuperscript{109}) ensures that prices are reasonable, but the contracting officer may use other price analysis methods and techniques to ensure price reasonableness if it cannot be ascertained through adequate competition.\textsuperscript{110}

Several GAO decisions have addressed price reasonableness versus price realism. In \textit{CSE Construction},\textsuperscript{111} the U.S. Army Corps of Engineers issued a solicitation for the design and construction of firing ranges. The solicitation asked offerors to propose prices for eight fixed-price CLINs and stated that price “will not be point scored but will be subjectively evaluated for reasonableness over the life of the contract.”\textsuperscript{112} CSE Construction submitted the lowest price, which was nearly $2 million less than the next lowest-priced offeror.\textsuperscript{113} The price evaluators concluded that CSE’s price was low and reflected a lack of understanding of the requirements, and the SSA awarded the contract to the next-lowest priced offeror.\textsuperscript{114} CSE filed a protest, alleging that the agency’s

\textsuperscript{108} FAR 15.404-1(a).

\textsuperscript{109} FAR 15.403-1(c)(1).

\textsuperscript{110} Id.

\textsuperscript{111} CSE Construction, supra note 21.

\textsuperscript{112} Id. at 2.

\textsuperscript{113} Id. at 3.

\textsuperscript{114} Id.
determination that its price was too low violated the terms of the solicitation, which did not provide for performance of a realism analysis.\textsuperscript{115} The GAO agreed with the protester, finding that “[t]he price evaluation factor provided only for the evaluation of the ‘reasonableness’ of the proposed price (that is, whether the price was unreasonably high) and for whether the price proposal was unbalanced, which is not contended here.”\textsuperscript{116} The GAO also found that the solicitation did not afford the agency the right to evaluate any cost or pricing information to determine whether an offeror understood the contract requirements.\textsuperscript{117} Moreover, even if the agency had correctly evaluated CSE’s low price as part of a responsibility determination, it would have been required to refer the matter to the Small Business Administration (SBA).\textsuperscript{118} The GAO concluded that the SSA should have considered CSE’s significantly lower price as an advantage, not a disadvantage.\textsuperscript{119}

CSE Construction was decided in 2002; agencies are still making the very same mistakes regarding realism versus reasonableness. A GAO decision issued in December

\textsuperscript{115} Id.

\textsuperscript{116} Id. at 4.

\textsuperscript{117} Id. (“Moreover, the RFP did not request cost or pricing information or any other information that would allow the agency to determine that a low proposed price reflected a lack of understanding of the contract requirements.”).

\textsuperscript{118} Id.

\textsuperscript{119} Id. (“We think that if CSE’s price advantage had been properly weighed in the agency’s price/technical tradeoff analysis, it would have had a reasonable possibility of being selected for award.”).
2009, *Milani Construction, LLC*, 120 exhibits the same confusion over price reasonableness versus price realism. In this decision, the National Park Service issued an RFP for rehabilitation of a park in Washington, D.C. 121 The solicitation contemplated award of a firm-fixed-price contract and provided that the agency would evaluate the nine CLINs for reasonableness and balance, but did not address whether a price realism analysis would be performed. 122 The agency received two proposals, and Milani Construction proposed a price 9.8% lower than the price proposed by the awardee. 123 The agency found that Milani’s lower price was unreasonably low when compared to the awardee’s prices and the government estimate and demonstrated that Milani might not understand the contract requirements. 124 As a result, the agency decided to award to the other offeror, Corinthian Construction. Milani protested on the basis that the agency introduced an unspecified evaluation criterion when it performed its price realism analysis, and the GAO agreed. 125 The GAO found that the agency confused price


121 *Id.* at 1.

122 *Id.* at 2.

123 *Id.* at 3.

124 *Id.* at 5.

125 *Id.* The agency argued that a general statement regarding assessing risk sufficed to put offerors on notice that a realism analysis would be performed. GAO dismissed this argument:

> While the agency contends that the price realism analysis was proper in light of certain language in the RFP… we disagree. In our view, the solicitation provisions to which the agency refers did not provide offerors with adequate notice that NPS intended to perform a price realism analysis, especially since the price evaluation factor – under which such notice would logically appear – did not
reasonableness analysis, which focuses on “whether the offered prices are higher than warranted,” and price realism analysis, which assesses whether “an offeror’s low price reflects on its understanding of the contract requirements or the risk inherent in an offeror’s approach.”  Because the agency failed to state an evaluation criterion assessing realism, the finding that Milani’s price was too low should have been part of a responsibility determination rather than a price reasonableness determination.  

It is apparent from this line of cases that the FAR needs to address what constitutes a price realism analysis and what constitutes a price reasonableness determination in more detail than is currently provided. As it stands, the regulation is silent on the issue, leading contracting professionals to issue solicitations that do not reflect the evaluations that they intend to perform.

B. WHEN THE AGENCY DOESN’T UNDERSTAND ITS OWN SOLICITATION

Another pervasive problem with realism analysis arises when agencies fail to perform a price realism analysis although the solicitation provides that one will be performed. GAO decisions in this area demonstrate that contracting professionals oftentimes insert language indicating that a realism analysis will be performed without

in any way suggest that a price realism analysis would be performed and offerors were not required to submit any cost or pricing information that could be used in such an analysis.

_Id_.

126 _Id_. at 4.

127 _Id_. at 5. The GAO found that since “submission of even a ‘below-cost’ price is not by itself improper,” an agency must put offerors on notice that the Government will be assessing whether a low price indicates a lack of understanding of the requirements. In this case, the solicitation did not provide offerors with that notice. _Id_. at 6.
understanding what inclusion of this language actually entails. For instance, in
*OMNIPLEX World Services Corporation*,\(^{128}\) issued in November of 2002, the
Immigration and Naturalization Services (INS) issued a solicitation for a Blanket
Purchase Agreement (BPA) to provide an electronic reporting system to track foreigners
in the U.S. obtaining an education that indicated that the agency would reject proposals
that were not realistic in terms of technical commitment or price.\(^{129}\) The agency made
award to B&W and OMNIPLEX protested on several grounds, including that the
awardee’s price proposal failed to provide price information, namely labor categories,
hours, and base rates, that the agency needed to evaluate its proposal in accordance with
the solicitation terms.\(^{130}\) The agency argued that although the solicitation required
submission of this information, it was not necessary to evaluate since this was a fixed-
price effort and the awardee’s rate fell into the mid-range of all the proposals
submitted.\(^{131}\)

The GAO found that the agency did perform a price reasonableness analysis but
failed to perform a price realism analysis.\(^{132}\) The contracting officer stated that she
“conducted a ‘price analysis in lieu of a price realism evaluation’”; however, since price
reasonableness analysis and price realism analysis are “not interchangeable,” and the
solicitation clearly stated that the agency would perform a realism analysis, the GAO


\(^{129}\) *Id.* at 2.

\(^{130}\) *Id.* at 8.

\(^{131}\) *Id.*

\(^{132}\) *Id.* at 9.
found that the protester was prejudiced by the agency’s failure to conduct its evaluation in accordance with the solicitation. The GAO recommended that the agency either reevaluate and perform a price realism analysis or amend the solicitation to remove the requirement to evaluate realism if it intended only to perform a price reasonableness analysis.

In procurement after procurement, contracting officers insert language requiring a price realism analysis without understanding the implications or the mechanics of performing such an analysis. For instance, in *Al Qabandi*, the Army issued a solicitation to provide laundry services in Kuwait and stated that “‘unrealistically low prices may be grounds for eliminating a proposal from competition.’” The Army subsequently awarded to the lowest-priced, technically acceptable offeror, and Al Qabandi protested on the basis that the award price was unrealistic, among other grounds. In response to this argument, the Army argued that there was no requirement in the solicitation to perform a price realism analysis, but undertook corrective action and affirmed award to the original awardee. Al Qabandi then asked the GAO for protest costs. The Army argued that

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133 *Id*. The GAO stated that if OMNIPLEX had known that the agency did not intend to evaluate price realism to ascertain whether proposed rates were too low, it might have altered its proposal accordingly, thereby making its proposal more competitive for award. *Id.*

134 *Id.*


136 *Id.* at 2.

137 *Id.*

138 *Id.*
Al Qabandi’s protest was not meritorious, but the GAO found that Al Qabandi’s challenge to the agency’s failure to perform a price realism analysis was valid because the agency failed to take into account that the solicitation did, in fact, require a price realism analysis.\(^{139}\) GAO stated that since the solicitation required a price realism analysis, the agency should have taken into account that the awardee’s price failed to factor in the increased cost of commencing performance in a short timeframe.\(^{140}\)

C. MOST PROBABLE COST AND FIXED PRICE EFFORTS

The only portion of the FAR that is clear regarding price realism analysis is the mandate that no most probable cost adjustment be made for fixed-price efforts; however, agencies still manage to misapply even this FAR provision. In IBM Corporation, the protester alleged that the Environmental Protection Agency improperly made adjustments to offerors’ proposed costs as part of “cost realism” and “total cost of ownership” analyses.\(^{141}\) The solicitation, which was for a software solution for the agency’s financial management system, called for offerors to propose whether the contract type would be fixed-price, labor hour, or time-and-material (T&M) for each area of work under the contract.\(^{142}\) IBM proposed to perform most of the work on a fixed-price basis and a small

\(^{139}\) Id. at 3.

\(^{140}\) Id. The Army argued that Al Qabandi’s initial protest lacked specificity, but the GAO rejected this argument. “In our view, however, the allegation was sufficiently specific that a reasonable investigation into the assertion would have led the agency to conclude that, contrary to the agency’s initial position, the solicitation in fact required a price realism analysis, and that it improperly failed to perform such an analysis.” Id.

\(^{141}\) IBM Corp., B-299504, June 4, 2007, 2008 CPD ¶ 64.

\(^{142}\) Id. at 2.
portion of the work on a T&M basis. During its evaluation, the agency made four upward adjustments to IBM’s price proposal based on concerns about IBM not capturing all its costs, seeking reimbursement for those costs, and requiring additional agency resources to implement its proposed technical solution. The contracting officer recommended award to CGI over IBM due to the price savings represented by CGI’s proposal.

During adjudication of the protest, the contracting officer stated that she could not determine whether the agency would have to reimburse IBM to replace a legacy system, so the cost adjustment was necessary. The GAO disagreed with her assessment and found that IBM’s proposal was unambiguous regarding inclusion of the price of replacement in its proposal. Since IBM’s proposal was fixed-price, it was improper for the agency to make upward adjustments to its price proposal.

D. INADEQUATE PRICE REALISM ANALYSIS

When an agency includes price realism analysis as part of its evaluation, it has to be sure that the form and extent of its realism analysis are well-documented and rational.

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143 Id. at 3.

144 Id. The EPA felt that upward adjustments to IBM’s proposal were required because IBM had not included any costs for anticipated future releases of its proposed software solution, would require additional EPA personnel during implementation of IBM’s solution, and would require additional operations and maintenance costs once implemented. Id. at 5.

145 Id. at 7.

146 Id. at 9.

147 Id. at 10. “As the FAR and our cases make clear, an agency may account for concerns regarding an offerors’ understanding of a requirement in the form of a performance risk evaluation, but may not adjust a fixed-price for purposes of evaluation.” Id.
Although the GAO frequently defers to the results of the agency’s realism analysis, occasionally a protester can successfully argue that the results of the agency’s realism analysis are unfounded. In *General Dynamics, LLC.*, General Dynamics and Unisys Corporation protested the Transportation Security Administration’s award of a fixed-price task order for computer support services to CSC. The protesters’ first argument regarding realism was that CSC proposed inadequate staffing to meet contract requirements and proposed a staffing plan that was inconsistent with its technical proposal. CSC proposed to cut staffing in the option years, but the GAO found that there was nothing in either CSC’s proposal or the agency’s evaluation which addressed the staffing cuts. The agency attempted to explain the lack of documentation as the result of the agency evaluating only the base year, but under the solicitation the agency was required to evaluate the base and all option years. The agency also argued that CSC built efficiencies into its proposal, but the GAO found that this explanation failed to account for the discrepancies between the staffing plan and the technical proposal, and

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148 *General Dynamics One Source, LLC; Unisys Corporation*, B-400340.5, B-400340.6, January 20, 2010, 2010 CPD ¶ 45. The RFP provided that:

> The Government will also evaluate the offeror’s Total Evaluated Price to determine fairness and reasonableness, as well as realism. The Government will assess how well the Total Evaluated Price realistically reflects an understanding of the solicitation requirements as well as a consistency with the approach proposed by the Offeror in the Volumes I-IV proposals. *Id.* at 6.

149 *Id.*

150 *Id.* at 8.

151 *Id.* at 9.
could not find any evidence that the agency considered the discrepancy in conducting its realism analysis.\textsuperscript{152}

The protesters’ second argument was that CSC’s labor rates were so low that there would be no way for CSC to comply with its proposed approach of hiring incumbent personnel.\textsuperscript{153} The agency argued that since offerors proposed fully burdened hourly rates, not wage rates, a comparison of rates alone did not show that CSC’s rates were actually lower than the other offerors. The agency also argued that it considered CSC’s low rates for several labor categories, but found that because CSC had the highest wages among offerors for several key positions, CSC would be able to retain incumbent key personnel, and its rates for the remaining labor categories were “competitive.”\textsuperscript{154}

The GAO sided with the protesters on this issue, finding no support for the agency’s argument that comparison among offerors’ rates was meaningless.\textsuperscript{155} The GAO also

\textsuperscript{152} GAO held:

While we find no basis for questioning the PET evaluator’s statement that CSC was able to achieve certain efficiencies with its proposed staffing approach (and correspondingly reduce its overall staffing profile), this statement – as with the two statements by the PET chairman – does not address the fact that the staffing proposed in CSC’s price proposal decreased significantly – by [deleted] FTE – in the option years of the contract and was inconsistent with the staffing in CSC’s technical/management proposal.

\textit{Id.} at 10.

\textsuperscript{153} \textit{Id.}

\textsuperscript{154} \textit{Id.} at 11.

\textsuperscript{155} \textit{Id.} In response to this argument, the GAO stated that “[m]ore specifically, the agency has not shown that it ever determined that there really was no substantial difference in the wage rate component of the burdened rates, and that the apparent difference was explained, for instance, by a substantial disparity in the two firms’ indirect rates.” \textit{Id.}
focused on the inconsistency in the agency’s argument: on the one hand, the agency argued that evaluation of CSC’s fully burdened rates was meaningless, but on the other, the agency stated that the higher rates for key personnel demonstrated that CSC’s proposal was realistic. Furthermore, the agency’s own documentation did not support arguments made during litigation: one of the members of the Source Selection Advisory Committee (SSAC) expressed concern that CSC would be unable to hire the incumbent workforce at its proposed rates. The agency dismissed this concern as “overstated” because the position in question was a relatively minor part of the overall effort. The GAO found that the agency did not properly address the SSAC member’s concerns, and stated that the fact that only one individual raised concerns about low rates did not “provide a reasonable basis for the agency to conclude that the impact of low wage rates would be limited to the director’s area of responsibility.”

E. WHEN THE AGENCY GETS IT RIGHT

_Aegis Defence Services, Ltd._ illustrates a price realism analysis performed correctly. This case involved a contract issued by the Department of Defense to provide personal security detail services in Iraq. DoD contemplated award of a firm-fixed price

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156 _Id._ (“If, as the agency suggest, the firms’ proposed labor rates provided no meaningful insight into wages actually to be paid, then it was unreasonable for the agency to rely on those same proposed rates to support a favorable evaluation of CSC’s ability to recruit, hire and retain certain key personnel.”)

157 _Id._

158 _Id._ at 12.

159 _Id._

contract and provided in the solicitation that price proposals would be evaluated for reasonableness and affordability. The solicitation stated that the agency “may reject a proposal that is evaluated to [have an] unrealistically high or low price when compared to contracting officials estimates, such that the proposal is deemed to reflect an inherent lack of competence or failure to comprehend the complexity, scope or risks of the program.” 161 The agency received three technically acceptable proposals: Aegis’ total price was $8,754,411, while the other two offerors came in at $5,678,082.44 and $15,940,217.35. 162 The contracting officer performed his realism analysis by comparing the prices of the three offerors CLIN by CLIN and by comparing the proposed prices to the incumbent contract to provide these same security services. 163 The agency found that the lowest-priced offeror, TigerSwan, was able to come in at a much lower proposed price than the other two offerors by staffing with third-country nationals, as opposed to expatriates, and by slashing its profit. 164 Based upon this information in conjunction with TigerSwan’s technically acceptable approach, the contracting officer found that TigerSwan’s pricing was realistic, and the SSA decided to make award to TigerSwan. 165

In its protest, Aegis challenged the agency’s finding that TigerSwan’s much-lower price was realistic because the comparison to the incumbent contract was

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161 Id. at 2.
162 Id.
163 Id.
164 Id. at 3.
165 Id.
invalid.\textsuperscript{166} The GAO upheld the agency’s evaluation, finding that the comparison to the incumbent contract provided a valid basis to perform a realism analysis.\textsuperscript{167} Aegis argued that the agency failed to account for differences between the incumbent contract and this contract, but the GAO found that the agency compensated for any differences in its analysis by breaking down the CLINs on the incumbent contract into the average per person/per month price and was therefore able to perform an accurate comparison of TigerSwan’s prices.\textsuperscript{168} On the basis of this comparison, the contracting officer was able to reach the valid conclusion that TigerSwan’s average monthly pricing was in line with the incumbent contractor’s average monthly pricing, and was therefore realistic, despite a small calculation error made by the agency.\textsuperscript{169}

In another decision where the agency properly performed a price realism analysis, \textit{G4S Government Services}, the Bureau of Immigration and Customs Enforcement (ICE) issued a solicitation for a requirements contract with fixed unit prices to support ICE’s alien reporting program.\textsuperscript{170} The SSA opted to make award to the higher technically-rated, lower-priced offeror, BI.\textsuperscript{171} G4S protested on the grounds that the agency performed a flawed price realism analysis based on how much lower the awardee’s price

\begin{footnotes}
\item[166] \textit{Id.} at 5.
\item[167] \textit{Id.} at 6.
\item[168] \textit{Id.}
\item[169] \textit{Id.} at 7.
\item[170] \textit{G4S Gov. Servs.}, B-401694, B-401694.2, November 4, 2009, 2009 CPD ¶ 236.
\item[171] \textit{Id.} at 3.
\end{footnotes}
was than the IGCE and the prices submitted by the other offerors.\textsuperscript{172} The GAO found that the agency’s realism evaluation was reasonable based on the fact that the agency performed an in-depth analysis of BI’s price proposal that included “an analysis of BI’s staffing ratios, BI’s use of different staffing ratios for different types of cases, and the comparison of BI’s staffing ratios to the current program staffing ratios, as well as the comparison of BI’s unit, CLIN, and overall prices to other offerors.”\textsuperscript{173} The GAO found that based on the thoroughness of the agency’s evaluation, the protester failed to demonstrate that the agency’s evaluation was inadequate or inconsistent with the solicitation.\textsuperscript{174}

In an interesting decision where neither the agency nor the offerors understood whether the solicitation required performance of a price realism analysis, \textit{FlightSafety Services Corporation}, the GAO found that the Air Force performed an adequate price realism analysis when the agency thoroughly investigated the awardee’s low price through discussions, even though the agency argued that no realism analysis was required.\textsuperscript{175} The solicitation, which contemplated the award of a fixed-price contract to provide services in support of the KC-135 Aircrew Training System (ATS), stated that the government “may reject any proposal evaluated to be unreasonable in terms of

\textsuperscript{172} \textit{Id.}

\textsuperscript{173} \textit{Id.} at 5.

\textsuperscript{174} \textit{Id.} The GAO found that the protester’s arguments merely amounted to disagreement with the agency’s conclusions, and stated that the agency has a great amount of discretion in determining the form and extent of its price realism analysis. \textit{Id.}

program commitments, including contract terms and conditions, or unreasonably high or low in cost when compared to government estimates, such that the proposal is deemed to reflect an inherent lack of competence or failure to comprehend the complexity and risks of the program.”

The awardee, CAE-USA, proposed a total price of $203,014,523, while the protester, FlightSafety Services Corporation (FlightSafety), proposed $308,826,384. FlightSafety argued that the language in the solicitation required the Air Force to perform a realism analysis and to reject CAE-USA’s proposal as unrealistic. Ironically, the GAO found that the Air Force performed a sufficient realism analysis where the Air Force argued that the solicitation did not require performance of an actual price realism analysis, but only required that the agency evaluate reasonableness. The GAO found that while the solicitation did not call for performance of a realism analysis per se, “it effectively provided for such an evaluation where it established that the Air Force could reject a proposal if the offeror’s low price indicated a lack of understanding.”

While the Air Force maintained that no realism analysis

176 Id. (citing RFP at 243).
177 Id. at 4.
178 Id.
179 Id.
180 Id. at 5.
181 Id. (“As explained above, analyzing whether an offeror’s fixed price is so low that it reflects a lack of understanding of solicitation requirements is the crux of a price realism evaluation, and by informing offerors that their proposals would be evaluated in this regard, the RFP established that the Air Force would, in essence, assess offerors’ prices for realism.”).
was required, by thoroughly investigating CAE-USA’s low price throughout the evaluation process and obtaining written confirmation from CAE-USA that the company would not operate at a loss, the agency did, in fact, perform a realism analysis.\textsuperscript{182} FlightSafety argued that the Air Force did not go far enough in probing CAE-USA’s low price, but the GAO found that since the form and nature of price realism analysis are squarely left to the judgment of the agency, the Air Force went far enough in confirming that CAE-USA could perform at its proposed price.\textsuperscript{183}

\textbf{F. COST REALISM DECISIONS}

While this thesis has focused on confusion in the area of price realism analysis, it is also informative to examine where agencies encounter difficulties performing cost realism analyses.\textsuperscript{184} The GAO and court cases in the area of cost realism analysis do not exhibit the same level of confusion as the price realism decisions, but rather are generally limited to agency confusion over making appropriate adjustments to the most probable

\textsuperscript{182} \textit{Id.} at 6.

\textsuperscript{183} The GAO went on to conclude that a “more probing inquiry was simply not contemplated by the RFP, or otherwise required, given that the RFP did not provide for the submission of the underlying cost information for CLINs 0003 and 0004.” \textit{Id.} at 8. The GAO wrote:

\begin{quote}
The record shows that the Air Force recognized that 1) CAE-USA’s price was low as compared with the prices submitted by the other offerors; 2) the issue was raised with CAE-USA in discussions; 3) CAE-USA expressly confirmed its understanding of the requirements, an understanding supported by CAE-USA’s experience performing similar requirements; and 4) CAE-USA explained that it was aggressively pursuing the contract and therefore intended for its price to be low since it viewed the contract as an important aspect of its corporate strategy.
\end{quote}

\textsuperscript{184} \textit{See, e.g., I.M. Systems Group, B-404583, B-404583.2, B-404583.3, February 25, 2011, 2011 CPD ¶ 64} (agency performed a flawed cost realism analysis when it compared proposed sample task prices to the Government cost estimate without assessing the realism of the proposed rates).
cost. The GAO’s examination of an agency’s cost realism analysis is limited to a review of whether the cost realism analysis was reasonable and not arbitrary.

Magellan Health Services involved a protest of Health and Human Services’ (HHS) award of a cost-plus-fixed-fee contract to provide employee assistance program services. The solicitation called for a cost-type contract and stated that the agency would perform a cost realism analysis to evaluate whether the proposed costs represent what the agency will pay for performance. The protester alleged that the agency did not perform a proper realism analysis on the awardee, Ceridian’s, proposal because the awardee proposed direct labor rates that were lower than the rates paid to the incumbent workforce and the contracting officer did not adjust the awardee’s price accordingly, despite the evaluators’ comments that the awardee’s rates were too low to ensure successful performance. The GAO found that the agency’s cost realism analysis was unreasonable because the contracting officer based the award decision on Ceridian’s

185 See, e.g., Earl Industries, LLC, B-309996, November 5, 2007, 2007 CPD ¶ 203 (agency performed a flawed cost realism analysis when it failed to adjust an offeror’s proposed cost to reflect prevailing area labor rates).

186 Marine Hydraulics.


188 Id. at 5.

189 Id. at 8.

While expressly accepting the cost analyst’s finding that Ceridian’s FPR had failed to propose the government-estimated levels of effort for the field consultant and field counselor labor categories as part of its direct labor costs, … the contracting officer did not consider the corresponding cost adjustment to Ceridian’s proposal, or address the concerns expressed by the TEP business review that Ceridian’s direct labor rates for the two key field labor categories needed to be “significantly increased.” Id. at 9.
proposed cost without making upward adjustments to account for the low direct cost rates.\textsuperscript{190} The GAO concluded that this improper analysis would have enabled the awardee to win the contract because of its lower costs, but then to recover the higher rates during performance when it was reimbursed for actual costs.\textsuperscript{191}

The GAO will not uphold an agency’s cost realism analysis if it is evident that the agency did not consider all available information in performing its evaluation. In \textit{The Futures Group International},\textsuperscript{192} the United States Agency for International Development (USAID) awarded a cost-type contract for reproductive health services in developing countries to Deloitte Touche Tohmatsu (Deloitte).\textsuperscript{193} The agency received two proposals and did not make any most probable cost adjustments to either proposal.\textsuperscript{194} Futures protested, arguing that it was unreasonable for USAID to accept Deloitte’s general and

\begin{quote}
\textbf{GAO stated:}

The agency’s argument here reflects a fundamental misunderstanding of what is required as part of a cost realism analysis. A cost realism evaluation implements an agency’s obligation to guard against unsupported claims of cost savings by determining whether the costs as proposed represent what the government realistically expects to pay for the proposed effort, based on the information reasonably available to the agency at the time of its evaluation. \textit{See Metro Mach. Corp.}, B-297879.2, May 3, 2006, 2006 CPD ¶ 80 at 9. HHS was fully aware of the incumbent employees’ existing salaries, and that Ceridian’s proposed pay rates were substantially less than the existing salaries (as well as the agency’s own IGCE).
\end{quote}

\textit{Id.} at 10.

\textit{Id.} at 12.


\textit{Id.} at 1.

\textit{Id.} at 2. The agency found that the costs presented in the offerors’ BAFOs were reasonable and realistic. \textit{Id.}
administrative (G&A) rates because they were significantly lower than Deloitte’s rates on
previous contracts.\textsuperscript{195} According to the protester, if Deloitte had proposed the higher
historic rates, it would have raised Deloitte’s costs by $14 million, making Futures’
proposed costs lower than Deloitte’s.\textsuperscript{196} Even though the agency acknowledged in the
evaluation record that it had concerns about Deloitte’s lower G&A rates, it made no
adjustments to the most probable cost.\textsuperscript{197} The GAO found that in light of the
contemporaneous record and the lack of explanation in Deloitte’s proposal, the agency
had no justification for accepting the lower rates in Deloitte’s proposal. Most probable
cost adjustments therefore should have been made.\textsuperscript{198} If this effort had been fixed-price,
the agency’s evaluation might have been adequate since the agency did acknowledge the
risk associated with Deloitte’s proposal. However, since this was a cost-type effort, the
agency was required to adjust Deloitte’s proposed cost accordingly.

In another decision where the agency failed to factor in all available information,
\textit{Marine Hydraulics International, Inc.},\textsuperscript{199} the Navy awarded a cost plus award and
incentive fee contract for ship maintenance and repairs.\textsuperscript{200} Because the work was

\textsuperscript{195} \textit{Id.} The agency did not have Deloitte’s negotiated indirect cost rate agreement on file
so it contacted another office within the agency and obtained Deloitte’s incurred cost
submission from 1997. \textit{Id.}

\textsuperscript{196} \textit{Id.}

\textsuperscript{197} \textit{Id.} at 3.

\textsuperscript{198} \textit{Id.} (“Deloitte’s cost proposal does not support its proposed indirect rates or justify
rates substantially lower than its historic rates, nor does it claim that the firm’s proposed
rates were lower because they were based on the receipt of this contract.”)

\textsuperscript{199} \textit{Marine Hydraulics Int’l., Inc.}, B-403386, November 3, 2010, 2010 CPD \textsection 255.

\textsuperscript{200} \textit{Id.} at 1.
unpredictable, the Navy included a notional work package and estimated labor hours for offerors to use in preparing their cost proposals.\(^{201}\) Marine Hydraulics (MH) protested the Navy’s decision to award to Earl Industries on the basis of an unreasonable cost analysis of its proposal.\(^{202}\) MH argued that the Navy improperly calculated its most probable cost as higher than it should have been.\(^{203}\) The Navy upwardly adjusted MH’s cost proposal on the basis that MH had historically charged security guard services as an indirect, as opposed to a direct, cost.\(^{204}\) The GAO sided with the protester, and found that the agency unreasonably added the cost of security guard services to MH’s proposed cost because the protester’s explanation for why it would charge security guard services as a direct cost was reasonable.\(^{205}\) The GAO also found that the agency should not have adjusted upward MH’s price in the area of fire watch services because the agency improperly factored in work categories that should not have been considered fire watch services.\(^{206}\)

\(^{201}\) Id.

\(^{202}\) Id. at 2.

\(^{203}\) Id. at 3.

\(^{204}\) Id.

\(^{205}\) Id. (“While MH’s practice under prior similar contracts might have been relevant, the FPR essentially explained why MH’s prior practice was not relevant. The agency never determined that this explanation was unpersuasive or unrealistic in any way, and even now has not established that there was reason to question the basis for MH’s indirect cost approach.”).

\(^{206}\) Id. at 4.
In general, agencies understand how to perform cost realism analyses; sustained protests in this area result mostly from failing to make adjustments to the most probable cost or going too far in adjusting an offeror’s proposed costs either upward or downward. The regulations are clear on when an agency must perform a cost realism analysis, but as the ABA Section pointed out, would benefit from reinsertion of the simple, straightforward explanation of why cost realism analysis is necessary. If contracting officers could see the “big picture” stated in the beginning of the subpart on cost realism analysis, it would make execution of the cost realism analysis a more straightforward process with less opportunity for agency missteps.

V. DO WE NEED PRICE REALISM?

Price realism analysis is undeniably confusing. Is it a necessary element of price evaluation, or could it, for example, be subsumed within a responsibility determination? Opponents of price realism argue that if offerors want to bid low on fixed-price efforts, it is at their own risk and the government should be able to take advantage of low prices when it has the opportunity. They argue that there are other ways to exclude offerors that bid too low without utilizing price realism – for example, offerors that are priced too low can be weeded out through responsibility determinations. Furthermore, bidding low is not forbidden – offerors are free to “buy-in,” and in some cases buy-in can work to the government’s advantage. However, given the tremendous amount of risk to both the government and to offerors when offerors are awarded contracts at prices at which they cannot perform, price realism can be a useful tool when properly utilized, and should be

207 ABA Section Letter, supra note 31, at 2. The ABA suggested reinserting the statement that “[t]he award of cost-reimbursement contracts primarily on the basis of estimated costs may encourage the submission of unrealistically low estimates and increase the likelihood of cost overruns.”
available for use by contracting officers in appropriate circumstances. In fixed-price procurements, the government cannot evaluate individual cost elements as it does in cost-reimbursement-type efforts, but price realism analysis provides the government with a tool to resolve doubts that arise with fixed-price bids. It opens the door for the government to take a deeper look into proposed prices than it otherwise would be permitted to do. If the FAR is revised to provide useful directions on when and how price realism should be employed, both the government and industry will reap the benefits of the added performance protection realism analysis provides.

A. THE BEST WAY TO EVALUATE REALISM

As pointed out by Professors Nash and Cibinic, as well as the GAO, the most logical means to evaluate price realism is to include it as part of the technical or risk evaluation or as part of the responsibility determination. While there is no mandate in the regulations that price realism be performed as a component of another type of evaluation and not as a stand-alone element of the price evaluation, recommending that contracting officers include it as part of the technical, risk, or responsibility determination would clear up a great deal of confusion without compromising the nature or form of the realism analysis. As part of the technical, risk, responsibility, or price evaluation, the result of the price realism analysis would remain the same: the agency would be able to determine if an offeror was bidding so low that it would be unable to perform successfully.

208 Nash & Cibinic, supra note 14; Milani Constr., supra note 28, at 4.

209 The current FAR simply states that results of a realism analysis “may be used in performance risk assessments and responsibility determinations.” FAR 15.404(d)(3).
VI. COMPARATIVE ASSESSMENT OF REALISM ANALYSIS

The international approach to price realism analysis focuses on the threat that below-cost bids present to successful contract performance, and grants contracting officials more latitude in assessing and rejecting low bids than the U.S. system. This is evident in both the United Nations Commission on International Trade Law (UNCITRAL)\textsuperscript{210} Model Law on Procurement of Goods, Construction and Services, and in the European Union Procurement Directives.\textsuperscript{211}

The UNCITRAL model laws are legislative texts that UNCITRAL recommends to the member states to incorporate into national law.\textsuperscript{212} States have flexibility and may alter the Model Law to best suit each country’s needs, but UNCITRAL encourages as few changes as possible to maintain uniformity in application.\textsuperscript{213} Although the Model Law on Procurement of Goods, Construction and Services was only introduced in 1994, in 2004 an update was commenced to “bring the Model Law into the electronic age.”\textsuperscript{214}

\textsuperscript{210} UNCITRAL was established in 1966 by the United Nations General Assembly to “further the progressive harmonization and modernization of the law of international trade by preparing and promoting the use and adoption of legislative and non-legislative instruments in a number of key areas of commercial law,” including procurement of goods. The UNCITRAL Guide: Basic facts about the United Nations Committee on International Trade, available online at http://www.uncitral.org/pdf/english/texts/general/06-50941_Ebook.pdf.


\textsuperscript{212} UNCITRAL Guide, \textit{supra} note 206, at 14.

\textsuperscript{213} \textit{Id}.

\textsuperscript{214} Wallace, \textit{supra} note 211, at 487.
The update focused on a number of areas, including electronic reverse auctions and abnormally low bidding, or what the U.S. system refers to as unrealistic bids.\footnote{Christopher R. Yukins, \textit{A Case Study in Comparative Procurement Law: Assessing UNCITRAL’S Lessons for U.S. Procurement}, 35 Pub. Cont. L.J. 457, 458 (Spring 2006).} The reforms to the UNCITRAL model laws can instruct U.S. procurement reform as it relates to realism analysis.\footnote{As Professor Christopher Yukins stated in \textit{A Case Study in Comparative Procurement Law: Assessing UNCITRAL’S Lessons for U.S. Procurement, supra} note 215 at 458, “What is striking about the UNCITRAL reform effort is not that U.S. procurement law has much to contribute to the working group (that is hardly surprising, given many decades of experience in the U.S. procurement system) but instead that the UNCITRAL debate has so much to offer U.S. procurement reform.” \textit{Id.}}

Prior to the reforms, the UNCITRAL Model Law was largely silent on the issue of abnormally low tenders. The revised UNCITRAL approach, following a European lead, encourages contracting officers to investigate low bids and to reject any bids that appear too low for the firm to successfully perform the contract.\footnote{The most recent version of the Model Law on abnormally low tenders reads as follows:}

\begin{quote}
\textbf{Article 20. Rejection of abnormally low submissions.}

(1) The procuring entity may reject a submission if the procuring entity has determined that the price in combination with other constituent elements of the submission, is abnormally low in relation to the subject matter of the procurement and raises concerns with the procuring entity as to the ability of the supplier or contractor that presented the submission to perform the procurement contract, provided that the procuring entity has taken the following actions:

(a) The procuring entity has requested in writing from the supplier or contractor details of the submission that gives rise to concerns as to the ability of the supplier or contractor to perform the procurement contract;

(b) The procuring entity has taken account of any information provided by the supplier or contractor following this request and the information included in the submission, but continues, on the basis of all such information, to hold concerns.
\end{quote}
to low bids originate in the new rules on electronic reverse auctions and concerns that
electronic bidding may lead to “‘auction fever’ and ill-considered low bids.”\textsuperscript{218} The
working group concluded that because of the performance dangers involved with low
bids, contracting officials should be encouraged to explore bids that appear too low even
though this increases the risk of discrimination against offerors.\textsuperscript{219} The UNCITRAL
model promotes broader probing of unrealistic prices than the U.S. system because
developing nations lack many of the safeguards that are available in the U.S., such as
“fear of default termination, sophisticated systems for assessing vendors’ financial
strength, performance security provided by a third party, or a bankruptcy system that
fosters project completion.”\textsuperscript{220} This necessitates the additional flexibility to reject low
bids. Unlike the U.S. regulations, the UNCITRAL Model Law gives specific direction as
to the actions that the contracting official should take in the face of a low bid. The Model

\begin{quote}
\textbf{(2)} The decision of the procuring entity to reject a submission in accordance with
this article, the reasons for that decision, and all communications with the
supplier or contractor under this article shall be included in the record of the
procurement proceedings. The decision of the procuring entity and the
reasons therefor shall be promptly communicated to the supplier or contractor
concerned.
\end{quote}

UNCITRAL Model Law on Public Procurement, available online at
http://www.uncitral.org/pdf/english/texts/procurem/ml-procurement-
2011/ML_Public_Procurement_A_66_17_E.pdf.

\textsuperscript{218} Wallace, \textit{supra} note 211, at 489.

\textsuperscript{219} Yukins, \textit{supra} note 216, at 480:

The proposed changes would vest contracting officials with substantial discretion
to exclude bids that seemed unrealistically low. … Because of this potential
discriminatory impact, the UNCITRAL working group members noted that it is
important to stress that the “price realism” review process must be transparent and
meant to enhance, not reduce, competition.

\textsuperscript{220} \textit{Id.} at 482.
Law still grants the official a tremendous amount of discretion to addressing an “abnormally low” price if the official continues to espouse concerns over the low bid after investigation.

The European Union Directives, like the UNCITRAL Model Law, serve to provide a framework for member states to enact their own version of the rules while allowing a certain amount flexibility for member states to introduce variations to account for particularities relative to that country’s procurement system.221 The Directives were first drafted in the 1970s and cover three areas: services, goods, and construction works.222 The European Commission keeps a “scoreboard” of the level of implementation for each member state, so the member states are incentivized to implement the directives within a set timeframe.223

The European Union Directives are governed by many of the basic principles that guide the U.S. system, such as “open competition, equity, and transparency.”224 In terms of realism analysis, the Directives, like the UNCITRAL Model Law, grant contracting officers the discretion to reject abnormally low bids but do not mandate their rejection.225

221 Jean-Jacques Verdeaux, Public Procurement in the European Union and in the United States: A Comparative Study, 32 Pub. Cont. L.J. 713, 721 (Summer 2003). Unlike the Federal Acquisition Regulation, the purpose of the directives in the European context is “drafting lines for national legislators and not a roadmap for procurement officers.” Id. at 723.

222 Id.

223 Id. at 725. The European Commission can bring an action against a member state that does not implement a directive within the set timeframe. Id.

224 Id.

Contracting officials are, however, required to investigate unusually low prices. If a contracting official decides to reject a bid as too low because there are no supporting circumstances justifying the abnormally low price, he must inform the European

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1. If, for a given contract, tenders appear to be abnormally low in relation to the goods, works or services, the contracting authority shall, before it may reject those tenders, request in writing the details of the constituent elements of the tender which it considers relevant. Those details may relate in particular to:
   (a) the economics of the construction method, the manufacturing process or the services provided;
   (b) the technical solutions chosen and/or any exceptionally favourable conditions available to the tenderer for the execution of the work, for the supply of the goods or services;
   (c) the originality of the work, supplies or services proposed by the tenderer;
   (d) compliance with the provisions relating to employment protection and working conditions in force at the place where the work, service or supply is to be performed;
   (e) the possibility of the tenderer obtaining State aid.
2. The contracting authority shall verify those constituent elements by consulting the tenderer, taking account of the evidence supplied.
3. Where a contracting authority establishes that a tender is abnormally low because the tenderer has obtained State aid, the tender can be rejected on that ground alone only after consultation with the tenderer where the latter is unable to prove, within a sufficient time limit fixed by the contracting authority, that the aid in question was granted legally. Where the contracting authority rejects a tender in these circumstances, it shall inform the Commission of that fact.

Id.

Commission of his only if the tender is abnormally low because the tenderer has obtained State aid.\textsuperscript{227}

Although the United States has the safeguards described above to protect against performance failure that many countries lack, the U.S. procurement system could benefit from the precautions implemented abroad because ideally abnormally low bids should be identified before any performance lapse can take place. The international procurement community grasps the serious ramifications of signing up to a low offer; the United States should be equally concerned and take similar precautions in order to avoid performance problems.

\textbf{VII. RECOMMENDATION}

FAR Part 15 needs to be rewritten to elucidate the purpose and mechanisms for a price realism analysis. As demonstrated by the GAO and court cases discussed above, many contracting officers “cut and paste” realism analysis language from past solicitations without understanding the consequences of including that language, or fail to provide for a realism analysis in efforts where one should be performed or where they intend to perform a realism analysis. Many contracting officers do not understand the difference between price realism and price reasonableness.

The FAR can be revised to provide practical tools to contracting officers and price evaluators without compromising the broad application of realism analysis that the committee that oversaw the FAR Part 15 rewrite sought to preserve. Implementation of the ABA Public Contract Law Section’s suggestion that cost realism and price realism should appear under separate sections would go a long way towards clearing up the

\textsuperscript{227} \textit{Id.}
confusion that presently exists. FAR 15.404-1 should be divided into three subparts: a subpart outlining the general objectives of price and cost analysis, a subpart on price analysis, and a subpart on cost analysis. Price realism analysis should appear under the price analysis subpart, and the FAR should be revised to include the term “price realism” rather than referring to cost realism analyses on competitive fixed-price incentive contracts or competitive fixed-price type contracts. The price realism definition suggested by the Section – “Price realism analysis is a means by which the government protects itself from the risk of poor performance where an offeror would incur a financial loss to properly perform the contract because its proposed price is unreasonably low” – should be revised to take out the reference to “unreasonably low” prices because it adds to the confusion regarding reasonableness versus realism. A more logical definition would be along the lines of: “Price realism analysis is a means by which the government protects itself from the risk of poor performance on a fixed-price effort where a vendor bids too low, or offers too low a price, to successfully meet contract requirements at the proposed price.”

The current FAR language is adequate in terms of conveying to contracting officers when a price realism analysis is appropriate. The language regarding “exceptional cases” should remain to stress that price realism analysis is appropriate for only a small number of procurements, when “new requirements may not be fully understood by competing offerors, there are quality concerns, or past experience indicates that contractors proposed costs have resulted in quality or service shortfalls.”

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228 FAR 15.404(d)(3).
In terms of guidance on how to perform a price realism analysis, the FAR should advise contracting officers up front that the best way to evaluate price realism is to include it as part of the technical or risk evaluation or as part of the responsibility determination, and should state that no most probable cost analysis may be developed for a price realism assessment. An example of the type of language that could be used is as follows:

For price realism analysis, unlike cost realism analysis, no most probable cost shall be developed. The results of a price realism analysis shall be incorporated into a technical evaluation as part of an ‘understanding the requirement’ factor, as part of the risk assessment, or as part of the responsibility determination. The solicitation shall state that if an offeror proposes a price that is too low, this will be reflected in either the results of the technical evaluation or the responsibility determination.

Guidance along these lines would not compromise the discretion afforded to contracting officers by the regulations, the GAO, and the courts; it would only make it easier for contracting officers to understand when price realism is appropriate, how to incorporate it into a solicitation, and how use the results of the realism analysis in an evaluation.