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Comptroller General
of the United States

United States Government Accountability Office
Washington, DC 20548

Decision

Matter of: Government Scrap Sales

File: B-295585

Date: March 11, 2005

Joseph Summerill, IV, Esq., and Frances Gardner, Esq., Barnes & Thornburg LLP, for the protester.
Craig A. Holman, Esq., and Kara L. Daniels, Esq., Holland & Knight LLP, for Liquidity Services, Inc., an intervenor.
Joel Zimmer, Esq., Defense Logistics Agency, for the agency.
Scott H. Riback, Esq., and John M. Melody, Esq., Office of the General Counsel, GAO, participated in the preparation of the decision.

DIGEST

Protest that proposed awardee of scrap property contract has an impermissible organizational conflict of interest (OCI) because a subsidiary company performs a related surplus property contract is denied; the theoretical possibility that the awardee will act in bad faith under its contract does not establish an OCI, and provides no other basis for denying firm the award.

DECISION

Government Scrap Sales (GSS) protests the proposed award of a contract to Liquidity Services, Inc. (LSI) under invitation for bids (IFB) No. 99-4001, issued by the Defense Logistics Agency (DLA), Defense Reutilization and Marketing Service (DRMS) for the sale of scrap materials. GSS maintains that award to LSI will result in an improper organizational conflict of interest (OCI).

We deny the protest.

BACKGROUND

DRMS is responsible for the disposal operations of the Department of Defense (DOD), including the reutilization, transfer, donation and sale of surplus DOD property. The sale of surplus property is accomplished through the award of contracts for the sale of property to vendors that in turn resell the property. DRMS utilizes two surplus property contracts: the commercial venture (CV) contract,

under which useable surplus commercial property is sold, and the scrap venture (SV) contract, under which scrap property that is no longer useable is sold. (This protest relates to the award of the SV contract.) The two contracts operate in a similar manner: the contractor purchases the property from DLA and then resells it, presumably at a price greater than the price paid to the agency. The contractor's (and agency's) return under both contracts is in the form of net proceeds, or distributions (gross revenue from the sale of the property minus the contractor's direct costs). The agency receives 80 percent of the distributions and the contractor 20 percent.[1] Under the SV contract, the contractor also may earn an incentive payment of up to an additional 10 percent of the contractor's distribution amount if (1) 60 percent or more of gross sales are made to concerns having 100 or fewer employees (5 percent), and (2) 50 percent or more of the sales to small businesses are to firms having 25 or fewer employees (5 percent).

Surplus Acquisition Venture, LLC (SAV), the current CV contractor, is a subsidiary of LSI.[2] GSS alleges that SAV's status as the CV contractor creates a potential OCI if the SV contract is awarded to LSI, since LSI/SAV would be able to manipulate the disposition of property to its advantage. Specifically, GSS asserts that SAV would have an incentive, and would be able to designate useable property as scrap in order to bring it under the SV contract, which, according to GSS, is more profitable than the CV contract. According to GSS, the small business participation incentives available under the SV contract allow for the possibility of the SV contractor earning as much as 25 percent of the net contract proceeds, while the CV contract provides for maximum possible earnings of only 20 percent.

In support of its conflict scenario, GSS poses a hypothetical example to demonstrate the economic incentive it claims LSI/SAV would have to convert surplus property under the CV contract to scrap under the SV contract. The example involves the sale of a 5-pound valve having an original acquisition value of $320. GSS asserts that it would be profitable for LSI/SAV to have SAV purchase the valve as surplus under the CV contract for a fraction of its original value--GSS hypothecates $.032--abandon the valve, and then have LSI repurchase it as scrap under the SV contract (at a hypothetical price of $.005), and then sell the valve at the same price for which SAV would have sold it under the SV contract, $100 in the example. While, according to GSS, the distribution to SAV would have been $19.9675 under the CV contract

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[1] Under the CV contract, DRMS receives 78.2 percent of the distributions and another concern, Kormendi/Gardner Partners (KGP) receives 1.8 percent of the distributions. KGP is an unrelated private concern that was awarded a consulting contract in 1997 to develop a model for privatizing DRMS's surplus sales responsibilities.

[2] Under both the CV and SV contracts, the winning contractor is required to form a separate entity known as the purchaser. SAV formed a concern known as Government Liquidation, LLC (GL) to act as the purchaser under the CV contract.

(20 percent of the $100 net proceeds minus the two purchase prices totaling $.0325), LSI would receive a distribution of $24.9675 if it took advantage of the small business incentives under the SV contract.

Although DRMS, not the CV contractor, has sole authority to designate property as either useable or scrap, GSS claims that there are three ways that SAV would be able to have property moved from the CV contract to the SV contract: (1) under the terms of the CV contract, SAV can abandon property that it is obligated to purchase, which allegedly would compel DRMS to divert the property to the SV contractor; (2) the CV contract specifically provides that SAV can refuse acceptance of any item that has an acquisition value exceeding $10 million, which would relegate the property to the SV contract; (3) under the CV contract, SAV can challenge the designation of property as useable and, thus, can influence the ultimate decision regarding the designation of property as useable versus scrap. Since LSI would have the incentive and the opportunity to essentially convert surplus property under the CV contract into scrap under the SV contract, GSS concludes, LSI has an impermissible OCI.

As a general rule, OCIs may be broadly categorized into three situations: impaired objectivity, unequal access to information and biased ground rules. American Mgmt. Sys., Inc., B-285645, Sept. 8, 2000, 2000 CPD ¶ 163 at 4. GSS has not articulated which of the three situations it believes is present here. However, we find that none applies. The unequal access to information and biased ground rules situations clearly are not applicable to this aspect of the protest.[3] In an unequal access to information situation, there must be some showing that the allegedly conflicted entity has had access to information not available to the other competitors, while in a biased ground rules situation there must be some showing that the entity had an opportunity (such as in preparing the solicitation) to influence the ground rules for the competition. Id. Under the third situation, impaired objectivity, the concern is that, because of the nature of a firm's actual or potential work under another government contract, it may be unable to provide objective advice or judgments to the government. Id. Here, because the CV contractor is not called upon by the terms of its contract to provide objective judgments regarding the disposition of property as useable versus scrap (such judgments are contractually the responsibility of DRMS), it follows that there can be no issue of an impairment of LSI's objectivity.

In the final analysis, GSS does not allege that LSI's objectivity will be impaired; rather, it alleges that, because of the additional potential profit available under the SV contract, LSI will have an incentive to act deliberately, in concert with SAV, to maneuver property offered to SAV under the CV contract to the SV contract. This amounts to an allegation that LSI may potentially engage in bad faith in its performance of the two contracts. However, there simply is no basis to deny a firm

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[3] We discuss separately below another aspect of GSS's protest in which the firm alleges that LSI had information not available to the other competitors.

an award due to bad faith that has not occurred but, rather, is a mere theoretical possibility.

In any case, we find the scenario outlined by GSS to be flawed in several respects. For example, GSS incorrectly asserts that LSI would be eligible to receive as much as an additional 5 percent of the net proceeds if it meets the small business participation goals set out in the solicitation--increasing its total distribution from 20 percent to 25 percent. The SV contract provides that each of the small business incentives may be as much as 5 percent of the total distributions to the contractor (for a total of 10 percent of the contractor's distributions), not 5 percent of the total net proceeds. IFB at 40. Thus, since the contractor's distribution is 20 percent of the net proceeds, meeting the small business incentives would increase LSI's distribution to no more than 22 percent of the net proceeds--10 percent of 20 percent--not 25 percent.[4] Thus, the additional profit on which GSS's scenario is founded--and, thus, LSI/SAV's supposed incentive to shift surplus property to the CV contract--would be substantially smaller than GSS describes.[5]

Further, GSS has not established that the valve in the protester's example would sell for the same price whether surplus or scrap, as the example assumes. Under the CV contract, the valve would be sold as is, and would presumably be purchased at the fair market value for a valve of its size and type. Under the SV contract, on the other hand, the contractor would be obligated to mutilate the valve before selling it as scrap. IFB at 19, 115. There is no basis to assume--and, again, GSS has not shown--that the net proceeds from the sale of an item as scrap under the SV contract would exceed the net proceeds from a sale under the CV contract, even with the small business participation incentives under the SV contract. Thus, again, the supposed profit incentive for converting surplus property to scrap has not been established.

GSS also asserts that LSI gained an improper competitive advantage in the SV contract competition by virtue of SAV's access to superior information as the CV contractor, and that LSI had an unfair advantage over other bidders because it could bid by planning to consolidate operations under the CV and SV contracts.

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[4] Applying the correct small business incentive amounts to GSS's example would reduce the potential distribution under the CV contract to $21.9675, and thereby significantly reduce the differential between the SV and CV contracts in the example.

[5] Further, the amount of the incentives aside, the incentives under the SV contract are in no way guaranteed. Rather, as noted above, they are available only if the contractor meets the solicitation's small business participation goals. The protester has presented no evidence--such as identifying small businesses that would be available to purchase scrap property--establishing that the incentives easily could be met.

These assertions are without merit. The advantages that LSI may enjoy by virtue of having its subsidiary perform the CV contract are nothing more than the advantages that would be enjoyed by any other incumbent contractor. The mere existence of a prior or current contractual relationship between the agency and the contractor does not create an unfair competitive advantage, nor is the agency required to compensate for every competitive advantage inherently gleaned by a competitor's prior or current performance of a particular requirement. Optimum Tech., Inc., B-266339.2, Apr. 16, 1996, 96-1 CPD ¶ 188 at 7. For example, an incumbent contractor's acquired technical expertise or firsthand knowledge of the costs of performing a requirement generally does not constitute an unfair advantage that the acquiring activity is required to eliminate. Id. Moreover, the mere fact that LSI may be more advantageously situated by virtue of its ability to consolidate operations under the two contracts is not the type of competitive advantage that the agency is required to eliminate; every contractor enjoys the advantage of its peculiar market position including, for example, economies of scale available to a large business, but not to smaller concerns. We conclude that LSI did not have an unfair competitive advantage.

The protest is denied.

Anthony H. Gamboa
General Counsel