When I first began drafting this article in August 2008, the original working title was “Energy Savings Performance Contracting: The Increasing Need in This Day of Skyrocketing Energy Costs.” At that time, the cost of oil was around $145 per barrel, and there were predictions that it would exceed $200 per barrel by the year’s end. As I began to revise the piece closer to the scheduled publication date in early 2009, however, the price of a barrel of crude oil had declined, as of November 21, 2008, by almost two-thirds. I had originally written “[i]t is news to no one that energy prices are increasing at an alarming rate.” The original thesis of the article, naturally, was that the need for energy savings performance contracting (ESPC) would inevitably grow with the escalating price of energy.

The question now becomes, though, whether the catastrophic economic developments that began to take shape in early autumn 2008, particularly as they have resulted in a downward spiral of energy prices, will reduce the need for ESPC. Although the opinions of some formerly well-respected economic forecasters no longer appear to hold sway, the just-published report of the National Intelligence Council (NIC) predicts an ever-increasing need and competition for scarce coal, oil, and gas commodities. The need for ESPC could well become more critical as a result of these recent events and the likely increase in demand for diminishing energy commodities. With full awareness of the recent global economic crisis, the NIC warns:

The international system will be challenged by growing resource constraints, and at the same time that it is coping with the impact of new players [Brazil, China, India, Russia], access to relatively secure and clean energy sources and management of chronic food and water shortages will assume increasing importance for a growing number of countries during the next 15-20 years. Adding well over a billion people to the world’s population by 2025 will itself put pressure on these vital resources.

The NIC report goes on:

However, all current technologies are inadequate for replacing the traditional energy architecture on the scale needed, and new energy technologies probably will not be commercially viable and widespread by 2025. The pace of technological innovation will be key. Even (continued on page 17)
Michael W. Mutek, Chair

Were you surprised during the September 26 presidential candidates’ debate to hear Senator John McCain say that he would stop the use of cost-plus contracting? It certainly generated a buzz within our community, but perhaps it should not have been a surprise because it was not the first time that this has been said. I pulled my file of articles on fixed-price contracts and found a 2006 article that mentions Senator McCain’s proposal to require fixed-price contracts for research and development unless the Department of Defense deems the program so technically challenging as to make fixed-price contracting impractical.1

The House also has raised this issue. In 2007, Rep. Henry A. Waxman introduced H.R. 1362, the “Accountability in Contracting Act,” to require agencies to limit the use of what some might call “abuse-prone” contracts. It sought to minimize the use of cost-reimbursable-type contracts because “[f]ixed price-type contracts provide the taxpayer the best value for the least risk in procuring items whose costs are well understood. Cost-plus contracts, the other main type of contract, leave the government vulnerable to wasteful spending since they provide the contractor with little or no incentive to control costs.”2

The reaction to the statement during the debate came from all quarters of the procurement community. One article noted that readers, “mostly current or former government employees, said it’s not that simple. Each approach has its place, and—here is the important point—neither one works if government does not develop and adhere to a clear set of requirements.”3 Some mentioned that the argument against cost-plus contracts fails to consider the reasons for selecting one contract type over another. For example, one reader said “[c]ost-plus contracts are a tool that fits better in certain circumstances than fixed-price contracts. Banning cost-plus is like banning wrenches. You could still get work done using pliers and hammers, but it would be cheaper and more effective to use the right tool for the job.”4

The acquisition community has seen other attempts to control costs through the use of firm-fixed-price contracts.

If you have been practicing in this area for awhile, you may recall that concerns about cost overruns resulted in the use of what was called “total package procurement” back in the 1970s. Total package procurement required a fixed-price type contract for design and development work, and fixed-price options for production and spares. The concept failed. Major programs suffered losses and massive claims.
Defense Contract Audit Agency Shines Spotlight on Lobbying Costs

BY CHRISTOPHER C. BOUQUET

In recent years, scrutiny of special interest lobbying of Congress has become fashionable. Despite the old adage that “there are two things you don’t want to see being made—sausage and legislation,” the media, government watchdog organizations, and some politicians seem determined to shine a spotlight on this process.2

These groups appear particularly concerned about legislative “earmarking,” the process by which legislators insert language in funding bills or reports that curtails the ability of the executive branch to control critical aspects of the funds allocation process.3 For government contracts, earmarks typically direct a specified amount of money to a particular contractor or project in a legislator’s home state or district. The critics complain that by circumventing established merit-based or competitive funding allocation processes, such earmarks serve special interests and not the public interest. One critic has even alleged that earmarks for contracts associated with the war on terror have damaged national security.4 It appears that the election of President Obama will not change the trend towards increased scrutiny of lobbying. Indeed, he has promised to “shine the light on Washington lobbying.”5

The various laws and regulations that govern the enterprise of lobbying the government fall into three broad categories: 1) rules requiring public disclosure of lobbying activities;6 2) rules governing the tax deductibility of lobbying costs;7 and 3) government contracting rules governing accounting for the costs of lobbying.8 Not surprisingly, the recent scrutiny of special interest lobbying in the “public square” has led to increased auditing of contractor compliance with these rules. Indeed, the Defense Contract Audit Agency (DCAA) has recently stepped up its auditing of contractors’ compliance with the lobbying cost accounting rules. To assist contractors’ preparations to withstand such audits, this article provides an overview of the lobbying cost accounting rules and discusses a DCAA audit alert issued last year that instructs auditors to pay special attention to contractors’ accounting for the costs of lobbying for earmarks.

Overview of the Lobbying Cost Accounting Rules

There are two major sets of government contracting rules applicable to accounting for lobbying costs: 1) the so-called “Byrd Amendment” rules governing accounting for the funds used to pay for lobbying for government contract awards,9 and 2) the principles set forth in Federal Acquisition Regulation (FAR) Part 31 concerning accounting for lobbying costs (the “cost principles”).10

The Byrd Amendment Rules. The Byrd Amendment rules prohibit recipients of appropriated federal funds from using those funds to pay persons or organizations to lobby Congress or an executive agency in connection with the award, extension, or modification of a contract, grant, or other funding instrument (“covered federal action”).11 The Byrd Amendment rules require contractors to track separately and to pay for the costs of covered lobbying activities out of funds that are not considered “federal.” The implementing regulations, however, specify that profits and fees from government contracts are not considered federal funds and may be used to pay for covered lobbying.12 Moreover, as long as a contractor can demonstrate that it has sufficient funds, other than federal funds, to cover the costs of its lobbying, there is a presumption that the contractor used these other monies.13

The Byrd Amendment rules are far-reaching. In particular:

- They preclude the use of federal funds to pay for the making, with the intent to influence, of any communication to or appearance before an officer or employee of any executive agency, a member of Congress, an officer or employee of Congress, or an employee of a member of Congress in connection with any covered federal action.14
- While there is no definition in the rules, the “making” of a communication arguably includes activities preparatory to the communication, such as the preparation of position papers and presentation slides, and follow-up activities, such as the development of conference notes or debriefings of individuals who were not in attendance at a meeting.
- The rules cover not only the costs of activities of outside consultants and lobbyists, but also cover the costs of efforts by a contractor’s officers, directors, or employees to influence a transaction.15
- The rules cover the costs of activities to influence the earmarking of funds for specific covered federal actions.16

The Byrd Amendment prohibitions do not apply to reasonable compensation paid to employees of the contractor for providing information specifically requested by Congress or an agency, or for agency and legislative liaison activities not directly related to a covered federal action, such as holding discussions with an agency regarding product capabilities, or adaptation of products for particular...
uses, that occur prior to the issuance of a solicitation. The Act also does not prohibit using appropriated funds to pay persons, including consultants, for "professional and technical services" provided directly in connection with the preparation, submission, or negotiation of any proposal for an award or for meeting requirements of the law pertaining to the award. Such services are limited to advice and analysis directly applying a professional or technical discipline to the proposal effort. If the services involve lobbying, then their costs are not allowable.

Solicitations for contracts expected to exceed $100,000 in value include FAR provisions stating that, by signing or submitting its offer, the contractor is certifying that, to the best of its knowledge and belief, no federal appropriated funds have been paid or will be paid for covered lobbying activities in connection with the contract. Prime contractors and subcontractors must obtain this certification from subcontractors that will receive subcontracts expected to exceed $100,000 in value. Moreover, all prime government contracts expected to exceed this amount include FAR provisions requiring compliance with the Byrd Amendment rules during the term of the contract, including the rules prohibiting use of federal funds to influence the extension or other modification of the contract. These provisions must be flowed down to subcontracts exceeding $100,000 in value at all tiers.

To meet the requirement to demonstrate that they have sufficient funds, other than appropriated federal funds, to cover the costs of their lobbying activities, contractors must identify and segregate these costs. Moreover, the costs must be excluded from contractor invoices under cost-reimbursable-type contracts or other claims for payment based on costs incurred. Such costs must also be excluded from cost estimates used to develop or support proposed prices for fixed-price contracts. In other words, the costs of covered lobbying activities must be treated as "unallowable costs" under government contracts. If they are not treated in this manner, then contractors will be vulnerable to allegations that federal funds were, in fact, used to pay for covered lobbying activities. In particular, the costs of some lobbying activities are allowable.29 There are exceptions to the cost principles on lobbying costs. In addition, some lobbying costs that are not made unallowable by the cost principles can lead to significant legal liability. Inclusion of unallowable costs in proposals or claims can result in the imposition of administrative penalties under the FAR. Moreover, contractors that are not compliant with the cost principles risk significant liability under the False Statements and False Claims Acts simply by submitting their proposals or invoices because each such submission might be considered to include a material falsity, i.e., a claim of entitlement to payment of amounts that are not recoverable under the regulations.

Some lobbying costs that are unallowable under the Byrd Amendment rules, such as lobbying for earmarks for specific covered federal actions in legislation, are also unallowable under the cost principles on lobbying costs. In addition, some lobbying costs that are unallowable under the Byrd Amendment rules, such as the costs of lobbying that strictly concerns executive branch decision making on contracting actions, are not made unallowable by the cost principles. Furthermore, some lobbying costs that are not made unallowable by the Byrd Amendment rules, such as lobbying concerning tax laws, are unallowable under the cost principles. Compliance with both sets of rules requires design and implementation of a comprehensive internal control system that identifies and segregates unallowable lobbying costs and directly associated costs. A key task in implementing such a system is the inclusion in all lobbying and consulting agreements of provisions requiring the maintenance of adequate records concerning the amount of effort spent on unallowable lobbying activities incurred. When a cost is unallowable under FAR Part 31, its "directly associated" costs are also unallowable.

The cost principles make unallowable the costs of lobbying concerning the introduction, enactment, or modification of federal, state, or local legislation on any topic, including program earmarks, taxes, environmental regulations, and particular government contract awards. Under the cost principles, the costs of legislative liaison activities, including attendance at legislative sessions or committee hearings, gathering information regarding legislation, and analyzing the effect of legislation, when carried on in preparation for or support of lobbying for legislation, are also unallowable. There are exceptions to the cost principles on lobbying costs. In particular, costs of the following activities are allowable if they are reasonable:

- providing to the Congress or a state legislature certain technical and factual presentations on topics directly related to the performance of a contract in response to a documented request;
- state/local legislative lobbying to directly reduce contract costs or to avoid material impairment of the contractor's ability to perform the contract; and
- any activity specifically authorized by statute to be undertaken with funds from the contract.

As with the Byrd Amendment rules, failure to comply with the cost principles can lead to significant legal liability. As such, contractors are required to demonstrate that they have sufficient funds, other than appropriated federal funds, to cover the costs of their lobbying activities. In particular, contractors must identify and segregate these costs. Moreover, the costs must be excluded from contractor invoices under cost-reimbursable-type contracts or other claims for payment based on costs incurred. Such costs must also be excluded from cost estimates used to develop or support proposed prices for fixed-price contracts. In other words, the costs of lobbying activities must be treated as "unallowable costs" under government contracts. If they are not treated in this manner, then contractors will be vulnerable to allegations that federal funds were, in fact, used to pay for lobbying activities. In particular, the costs of some lobbying activities are allowable. There are exceptions to the cost principles on lobbying costs. In addition, some lobbying costs that are not made unallowable by the cost principles can lead to significant legal liability. Inclusion of unallowable costs in proposals or claims can result in the imposition of administrative penalties under the FAR. Moreover, contractors that are not compliant with the cost principles risk significant liability under the False Statements and False Claims Acts simply by submitting their proposals or invoices because each such submission might be considered to include a material falsity, i.e., a claim of entitlement to payment of amounts that are not recoverable under the regulations.

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in each month that the lobbyist or consultant does any work for the company, in relation to the total effort spent by the lobbyist or consultant on all company activities in that month. It also requires training and educating of employees to identify and separately record the time they spend on lobbying activities covered by the rules.

The DCAA Audit Alert
As mentioned above, DCAA has increased its scrutiny of contractors’ compliance with the lobbying cost accounting rules. Indeed, on April 24, 2008, DCAA’s assistant director of policy and plans issued an audit alert instructing auditors to pay special attention to contractors’ accounting for the costs of lobbying for earmarks. The audit alert instructs auditors, as part of routine audits of contractor costs, to review certain databases that identify recipients of earmarks. If the auditors find a “significant” earmark to the contractor, auditors are to make inquiries to the contractor to determine the procedures the contractor uses to identify and collect the costs related to pursuing earmarks.

DCAA’s inquiries are to include interviews with “responsible contractor personnel to ascertain the nature and extent of effort provided to support the identified earmark.” According to the audit alert, DCAA is interested in determining whether contractor effort to support lobbying for earmarks extends beyond company lobbyists and executives to include program management, contracting, public relations, consultants, and technical personnel. If the effort extends to a larger group, DCAA will want to determine whether everyone is recording time to an unallowable charge code. In addition, DCAA will scrutinize costs that are “directly associated” with unallowable lobbying costs, e.g., travel and meeting expenses. The audit alert states that “many significant earmarks . . . require contracting personnel to attend meetings with congressional members or their staff to pursue earmark funding.” Thus, contractors should expect more questions about the purpose of travel to government facilities, especially those that are in the Washington, D.C., area. The audit alert states that additional guidance addressing audits of earmarks will be issued in the “near future.”

Conclusion
Through its stepped-up auditing activities, including the recently issued audit alert, DCAA is shining a spotlight on contractors’ lobbying costs. Contractors should prepare themselves to withstand DCAA audits of such costs by designing and implementing robust internal control systems that identify and segregate unallowable lobbying costs and directly associated costs.

Endnotes
9. 31 U.S.C. § 1352; 48 C.F.R. § 52.203-12. These rules also mandate that contractors make certain disclosures of lobbying contracts.
12. 48 C.F.R. § 52.203-12(b)(1).
13. Id. at § 52.203-12(b)(2).
14. Id. at § 52.203-12(a) and (b).
15. Id.
17. 48 C.F.R. § 52.203-12(c)(1).
18. Id. at § 52.203-12(c)(2).
19. 48 C.F.R. § 3.808(a); 48 C.F.R. § 52.203-11; 48 C.F.R. § 52.212-3(e).
20. 48 C.F.R § 52.203-12(g).
21. 48 C.F.R. § 3.808(b); 48 C.F.R § 52.203-12; 48 C.F.R § 52.212-4(r).
22. 48 C.F.R. § 52.203-12(g). FAR § 52.203-12 is not listed in FAR § 52.244-6, Subcontracts for Commercial Items, or FAR § 52.212-5(e), Terms and Conditions Required to Implement Statutes or Executive Orders-Commercial Items, as a mandatory flow-down to subcontracts for “commercial items.” However, it should nonetheless be flowed down to all subcontracts exceeding $100,000 because the statute applies to all such subcontracts.
25. 48 C.F.R. § 31.102(b)(1).
27. 48 C.F.R. § 31.201-6.
28. 48 C.F.R. § 31.205-22(a)(3). FAR § 31.205-22(a)(1), (2), (4) and (6) also make unallowable the costs of certain political activities and attempts to influence executive branch employees to act regarding a contract on any basis other than the merits.
29. Id. at § 31.205-22(a)(5). When a contractor seeks reimbursement for indirect costs, total unallowable lobbying costs must be separately identified in the indirect cost rate proposal and thereafter treated as other unallowable activity costs. Id. at § 31.205-22(c).
30. Id. at § 31.205-22(b). To be allowable, these costs must meet the general allowability criteria in FAR § 31.201-2.
31. 48 C.F.R. § 52.215-10, Price Reduction for Defective Cost or Pricing Data; 48 C.F.R. § 52.242-3, Penalties for Unallowable Costs.
34. Whether DCAA has contractual authority to interview contractor personnel has been the subject of considerable debate.
35. Memorandum from assistant director of policy and plans, supra note 33.
Lessons Learned from the Collapse and Rebuilding of the I-35W Bridge: Would the Model Code for Public Infrastructure Procurement Have Made a Difference?

BY JEFF H. ECKLAND AND DAVE S. LAIDIG

The I-35W highway bridge: 13 people died and more than 145 were injured as a result of the collapse. The disaster presented a unique confluence of economic necessity to rebuild the lost bridge with the desire to demonstrate Minnesota’s resilience. Following the collapse, Governor Tim Pawlenty announced the replacement structure would be completed by December 2008. The state immediately commenced work, responding to victims, cleaning up the disaster site, assisting with various investigations, and soliciting proposals. The actual award of a contract for the new bridge proved more difficult.

Years from now, we could drive on new roads, depend on safe bridges and stronger levees, and connect our cities with high-speed rail. . . . That’s what we must do to make sure that America runs on a strong, fair, and efficient foundation.

—Barack Obama
June 26, 2007
Pittsburgh, Pennsylvania

The federal investigation [into the I-35W bridge collapse] is nothing more than a political smokescreen for politicians to dodge and deny the issue of crumbling infrastructure in America.

—James Schwebel
Minneapolis StarTribune
March 28, 2008

Challenging times require creative and collaborative action. On August 1, 2007, the State of Minnesota faced one of its most devastating public disasters with the collapse of the I-35W highway bridge: 13 people died and more than 145 were injured as a result of the collapse. The disaster presented a unique confluence of economic necessity to rebuild the lost bridge with the desire to demonstrate Minnesota’s resilience. Following the collapse, Governor Tim Pawlenty announced the replacement structure would be completed by December 2008. The state immediately commenced work, responding to victims, cleaning up the disaster site, assisting with various investigations, and soliciting proposals. The actual award of a contract for the new bridge proved more difficult.

Approximately one year after the bridge collapse, Minnesotans began driving over one of the most modern concrete-spanned bridges in the nation. There is no scarcity of pundits who claim that the collapse of Minnesota’s I-35W bridge is symptomatic of a greater crisis regarding the deteriorating condition of our nation’s infrastructure. Few, however, have offered a way to move forward. And fewer still have examined Minnesota’s rebuilding experience for clues about how to deal most effectively with our larger national problem. Recently, the National Transportation Safety Board (NTSB) concluded that the I-35W bridge collapse was largely due to improperly designed gusset plates, but the question for the future remains: Has government done all that it can to ensure that public infrastructure procurement is conducted effectively?

Minnesota’s Rebuilding Experience

The new I-35W bridge has attracted much acclaim, largely because of the elegance of its concrete spans and the apparent ease with which it was erected. Its very success, though, points to what has become a major issue in its rebuilding.

Whether or not the Minnesota Department of Transportation (MnDOT) ever had a predisposition for a concrete design, the most vitriolic debate has centered on the fact that the state’s solicitation generated only one bid with a concrete design. As it turned out, that concrete design resulted in the winning bid, even though it presented the highest cost as well as the longest construction schedule. Adding insult to injury, the cost increased sub-
substantially, to the tune of $200,000 for each day the contract was completed early, when the contractor was able to significantly shorten the completion schedule from December to September 2008. As a result, the already highest original cost bid was increased to a total of nearly $260 million, roughly $76 million higher than the next lowest bid of $184 million. The criticism that has arisen over time is that, had the State of Minnesota more clearly defined its needs, it would have received more than one proposal for a concrete design. Arguably, the evaluators then would have been in a position to choose a concrete design that was more cost-effective, or had a shorter construction schedule, or both.

This episode presents significant questions: How could these issues have been avoided? And, more important, how can similar issues be avoided in the future? Does an examination of the procurement mechanisms themselves help inform us whether Minnesota's needs were met in the rebuilding process? Are there lessons to be learned before our nation embarks on the infrastructure improvement projects we need to undertake in the next generation? How important is it for all the states to adopt uniform, well-thought-out procurement statutes to streamline the important work that needs to be done?

In an effort to help identify these and other questions, and to suggest possible answers, this article examines the issues of selecting a procurement method, determining requirements, defining "best value," and allowing for a protest system. Further, we will compare the likely outcomes in the event that Minnesota previously had adopted a uniform statute governing public infrastructure procurement such as the 2007 Model Code for Public Infrastructure Procurement (the MC PIP), drafted by the ABA's Section of Public Contract Law. In particular, we examine several aspects of how the existing MC PIP, if it had been adopted in Minnesota, would have affected the state's experience in rebuilding the I-35W bridge.

Selection of Contracting Method

Source Selection Under Minnesota Law

In order to replace the bridge, Minnesota first needed a design and the labor and materials to build it. Minnesota law provides for a variety of methods from which to choose for delivering a replacement bridge.1

The first option is to award a construction contract using the statutory authority granted for emergencies. Generally, under emergency conditions, direct selection would be the method used to react quickly to emergency conditions. Like sole- or single-source selections, however, the use of emergency authority is more of an exception to authorized procurement methods than a method itself. In short, Minnesota law provides statutory authority to suspend normal competitive bidding requirements during an emergency.2 The day after the collapse, the governor did issue an emergency declaration. Although the state did not award the I-35W bridge contract pursuant to its emergency authority, state officials later asserted the ability to do so. As a matter of public policy, the question whether rebuilding a highway bridge should ever be an emergency procurement is certainly debatable and is an issue not clearly settled under Minnesota law.

The second procurement option is a design-bid-build approach, a two-step process where, in the first step, a designer is selected. The MnDOT has a prequalification program where many architectural, engineering, and design firms are placed on a prequalified list. A designer can also be selected via a full RFP process using a "best value" approach where price and other factors are considered. The law also allows for a qualifications-based selection (QBS) approach that is generally used where federal funding is involved. In the second step of the process—following the selection of a design—bids are sought for the construction (or the "build" piece of a design-bid-build) of the selected design. This selection process can be either on a "low bid" or a "best value" basis.

Thus, the design-bid-build process allows for the greatest competition for both the structure's design and construction. For example, a superior design can be paired up with the least expensive or quickest construction team. With the I-35W bridge procurement, only one design team proposed a concrete bridge, while the others proposed a steel structure. The concrete structure earned the highest technical score by all six of the agency's evaluators. If this design had been selected in a design-bid-build process, all of the construction teams would have bid on the winning concrete design, and provided a variety of cost options for the agency. The extra time required for two separate procurements, however, is the greatest drawback to this process, and protests can increase delays even more. In an environment such as Minnesota, where the construction window may be narrow due to adverse weather, a delay of a few months may mean missing the construction season altogether, and can translate into a lost year.3 Under MnDOT's formula for evaluating the proposals for the I-35W bridge replacement, a six-month delay would result in an imputed cost to the community of over $73 million in lost revenue, increased commuter expenses, and burdens on surrounding roads.

The final option allowed under Minnesota law is a design-build procurement.4 The design-build process combines multiple stages into one process by having a designer jointly bid on the project with a construction firm. There is both a "low bid" design-build method and a "best value" design-build method. Under a "low bid" design-build method, award is made to the lowest bidder that has met all the specifications. Under the "best value" design-build method, each design-build bidder or team receives a score that combines technical design elements and cost elements. In this fashion, the competitive process is shortened, and the attendant costs associated with multiple bidding competitions, and possible challenges, are minimized. However, this process also reduces the checks and balances of open competition. For example, the design for a winning bid will be built by the construction partner, regardless of whether other companies could have delivered the chosen design in a shorter time frame or at a lower cost.
Similarly, a superior construction team may overshadow a less desirable design in the complex formula. The central challenge is to balance the strengths and weaknesses of a design against cost considerations.

Procurement officials in Minnesota are given wide latitude in determining which contracting method to use. Limitations typically involve the amount of the expenditure and the availability of competition. Although Minnesota law does provide for a QBS process, the great majority of professional services contracts are acquired using a “best value” assessment that must include an evaluation of price along with qualitative factors. Further, at the time of the I-35W bridge replacement, design-build contracts were limited to 5 percent of procurements, by number of construction contracts awarded annually. Minnesota ultimately chose the design-build method, in part because it was the quickest means of awarding the contract competitively. Other considerations weighing in favor of the design-build method included shortened completion time by overlapping design and construction; faster commencement of construction before the finalization of all design details; and the accelerated response time and other benefits flowing from the existence of a team effort encompassing both design and construction.

Source Selection Under the MC PIP

Like Minnesota law, the MC PIP recognizes similar methods for procurements relating to the design and construction of infrastructure. In a design-build procurement, a qualifications-based process is used to procure architect and engineer services, and competitive sealed bidding is used to procure construction services. Under a design-build delivery method, contracts are procured through competitive sealed proposals. These proposals are then evaluated as a whole according to predetermined weighted evaluation criteria.

The MC PIP differs from Minnesota law in how it limits the discretion of a procurement officer in choosing a delivery method by requiring the establishment of regulations to guide the choice of delivery method. The regulations must: (i) set forth the criteria that are used for determining a delivery method; (ii) grant the chief procurement officer (CPO) or agency head the discretion to choose an appropriate project delivery method; and (iii) require the inclusion in the contract file of a written statement setting forth the facts that led to the selection of the project delivery method.

Existing Minnesota law requires the evaluation of specific criteria before selecting a design-build procurement. A report of the evaluation of the criteria also must be made available to interested parties. In some respects, therefore, Minnesota law creates more accountability than required under the MC PIP, although these differences could be incorporated into the regulations required by the MC PIP.

The MC PIP also differs from Minnesota law by providing additional guidance for emergency procurements. For example, under MC PIP § 3-106, an emergency procurement is permitted when there “exists a threat to public health, welfare, or safety under emergency conditions,” and it requires “such competition [for the contract] as practicable under the circumstances.” The MC PIP allows for a “special procurement” that would permit the waiver of some competitive bidding or proposal requirements, including time and notice requirements. Additionally, the CPO is required to make a written determination of the basis for this type of procurement and for the selection of the particular contractor, which will be made available for public inspection. Thus, in an emergency situation, a state implementing the MC PIP would follow normal contracting procedures, but impractical requirements could be waived through a written determination. This outcome would balance the accountability required for maintaining the competitive nature of procurements with the unusual circumstances presented by emergencies.

Although it is not known whether MnDOT seriously considered rebuilding the bridge under emergency authority without any competitive process, it appears that the adoption of the MC PIP would have removed any uncertainty in this regard. In exchange for this clarity, however, Minnesota would have faced the challenge of adopting new regulations to curb the procurement officer’s discretion in choosing a contracting method. Under the MC PIP, MnDOT would have the authority to select a design-bid-build contracting method in an emergency, and tailor the process to remove otherwise adverse aspects of this method. If the MC PIP’s “special procurement” method had been available to MnDOT, the concrete-versus-steel bridge controversy could have been eliminated. Indeed, a “special procurement” would have advanced the interests of private businesses seeking the award as well as the state’s interests in securing the least expensive, highest quality design in the shortest possible time. The selection of a concrete design first, followed by bids for its construction, would have increased contractor participation and likely resulted in a lower cost concrete bridge. Although Minnesota’s evaluation criteria are explicitly required when considering design-build contracts, the MC PIP would allow for a broader range of contract decisions.

Identifying Contract Requirements and Enhancing Competitive Bidding

One of the most difficult challenges for both the state and potential contractors was to identify the desired qualities and characteristics for the new I-35W bridge. MnDOT issued the RFP only 22 days after the bridge collapsed. During that three-week period, the agency had to respond to the incident, coordinate resources, and preliminarily determine a cause of the collapse so that the requirements for the replacement bridge could be developed. Additionally, the new bridge needed upgrades to match local street development and increased traffic. Considering the complexity of the task, it is no surprise that there were six amendments to the RFP, a 30-page document describing a $250 million contract, with the last amendment being issued three days before the bidders’ final submissions to the agency. The time pressure to develop the requirements was...
intense, with little margin for error.

Amidst the confusion of the immediate aftermath, some bidders felt that the circumstances required that a steel bridge needed to be built. A steel bridge would have best addressed the immediate and continuing economic impacts of the bridge collapse since concrete bridge construction generally takes longer and is more expensive. However, neither the RFP nor its amendments identified a preference for steel over concrete. In the end, whether or not MnDOT in fact harbored a preference for concrete over steel, the bidders that offered steel bridges felt they were excluded from a chance to compete for the design and construction of a concrete bridge because of a lack of specificity in the RFP.

Under the MC PIP statute, the solicitation must be defined to “maximize practicable competition.” Although by itself the MC PIP would not have required disclosure of the preference for a concrete bridge—if indeed there ever was such a preference—it would have encouraged the promulgation of detailed, agency-specific regulatory guidance. For example, a discrete review period might be mandated with all of the decision makers in one setting. In the context of the I-35W bridge rebuilding project, a review of available resources and requirements should have been formalized before issuing the RFP. From such a hypothetical regulatory requirement, actual preferences might have been more formally identified and communicated to all prospective bidders.

A common refrain among private sector bidders is, “We would have sold it to the government if we just knew what the agency wanted.” In a scenario requiring accelerated procurement, such as this one, the consequences of delays and insufficient competition become more costly than ever. By failing to address adequately what have become the major concerns of actual bidders, MnDOT may well have alienated potential contractors and lost potential so-

**Determining “Best Value” and the Role of Price**

In what has been the most visible procurement decision in Minnesota’s recent history, MnDOT awarded the contract to the design-build team with the longest completion time and the highest cost. Awarding a contract to the highest bidder led to public criticism and efforts to explain the concept of “best value” in layperson’s terms. Minnesota generally requires that at least 30 percent of evaluation points be awarded based on cost. The I-35W bridge contract, however, was subject to a statutory exception, enacted in 2001, that resulted in a best-value formula of cost (in this case, proposal price plus the imputed economic cost of construction time at $200,000 per day) divided by the technical score. Although the formula for determining the awardee was identified in the RFP, the result is somewhat counterintuitive.

The technical score had a maximum 100 points, with evaluation criteria for quality (worth 50 percent), aesthetics/visual quality (20 percent), enhancements (15 percent) and public outreach (15 percent). The winning bid had a technical score of 91.47 points, and the overall second place finisher had a technical score of 65.91 points. Although the technical scores were quite different, the actual competition for the contract was relatively close. The bidder with the highest technical score also had the longest completion time, 70 extra days, and the highest direct cost of more than $233 million. The second-place bidder had the lowest cost and the shortest completion time, which, according to the evaluation formula, resulted in a cost near-

The large monetary difference could have been erased with slight changes to the technical scores. Indeed, increasing the lower score by four points, or reducing the higher technical score by seven points, would have made the alternative bidder the presumptive awardee. Considering that “public relations” and “approach to involve stakeholders” adds up to 25 potential points (i.e., 25 percent of the overall technical score), bidders and the public began to question whether the best value was actually obtained. The large difference in technical scores raised additional questions. Some of the contractors familiar with MnDOT contracts were surprised that one bidder had a technical score 25 percent higher than all the others. This contrast with past practice also served to reduce confidence in the process.

On this point, Minnesota law mirrors the MC PIP procedures. Under the MC PIP, a design-build procurement uses competitive sealed proposals. The RFP must state the relative importance of demonstrated compliance with the design requirements, offeror qualifications, financial capacity, project schedules, price, and any other factors. The factors included in the RFP are the only factors that may be used in evaluating a proposal. The contract will be awarded to the proposal that conforms to the solicitation, and is the most advantageous to the purchasing agency according to the enumerated evaluation factors. The agency’s contract award can only be judicially overturned if it is clearly erroneous, arbitrary, capricious, or contrary to law. In these respects, Minnesota law mirrors the MC PIP’s procedures.

The debate over the inclusion and weighting of subjective design factors in the procurement process likely will continue. Because this issue is fact-intensive, the MC PIP in its current form does not settle the issue. Each jurisdiction should ensure that subjective factors do not overwhelm cost considerations. Above all, regulation and policy should reinforce an agency decision that identifies required features, and the extent to which “enhancements” will be rewarded.

**Bid Protest Procedures**

Even though Minnesota law does not provide for formal bid protest procedures, protests of the contracting process are not uncommon. In this case, the RFP specified various procedures that were to be binding upon all parties submit-
ting proposals. Two of the four prequalified design teams challenged the award by submitting a consolidated bid protest within 24 hours, per the RFP instructions, of the identification of a presumptive award winner.\textsuperscript{27} The bid protest raised three general arguments, specifically: (i) the scoring results were erroneous; (ii) the highest bidder could not be the “best value”; and (iii) the procedures required by the bid protest were improper. Following an agency response and rebuttal,\textsuperscript{28} the protest officials deemed the criteria permissible by statute, and characterized the formula for calculating the award winner as an illustration of how “best value” can differ from “low bidder.” In this instance, the deadline for filing protests passed before the agency revealed specific data on proposal scoring. This led to concerns that protestors could not adequately pursue a remedy because they had been denied access to potential evidence.\textsuperscript{29} However, the protest officials considered the criticism of the actual protest procedures to be beyond the scope of their authority to remedy.\textsuperscript{30} The award decision was upheld through administrative appeals, and 68 days after the collapse, MnDOT awarded the I-35W replacement bridge contract.

The MC PIP includes a fairly liberal bid protest procedure. Any actual or prospective bidder, offeror, or contractor that has been aggrieved by the solicitation or award of a contract may submit a protest directed to the chief procurement officer.\textsuperscript{31} A protestor must submit its protest in writing within 14 days of the time the protestor knew or should have known the facts giving rise to the protest.\textsuperscript{32} After a timely protest, the award or solicitation is frozen until the controversy is resolved.\textsuperscript{33} The CPO then issues a written decision and informs the protestor of its right to judicial review.\textsuperscript{34}

The MC PIP also provides for state court jurisdiction where a protestor brings an action against the purchasing agency alleging that the solicitation or award violates the state constitution, statutes, or regulations, or the terms and conditions of the solicitation.\textsuperscript{35} In a judicial action, the factual or legal determinations by the purchasing agency are not final or conclusive.\textsuperscript{36} All court actions must be initiated within 30 days after the aggrieved person knows or should have known the facts giving rise to the action, or within 14 days after receipt of a final administrative decision.\textsuperscript{37}

The MC PIP also provides remedies for successful protests.\textsuperscript{38} If a protest is successful prior to the contract award, then the solicitation or proposed award shall be cancelled, or revised in order to comply with the law.\textsuperscript{39} If a protest is successful after a contract award, then the available remedies depend upon whether the contract awardee is determined to have acted fraudulently or in bad faith.\textsuperscript{40} If the awardee has acted fraudulently or in bad faith, then the contract may be declared null and void, or ratified if such a result is in the best interests of the purchasing agency.\textsuperscript{41} If the awardee did not act in bad faith or fraudulently, then the contract may be affirmed if such a result is in the best interests of the purchasing agency, or terminated, in which event the awardee will be compensated for actual expenses incurred and reasonable profits earned during the time of award.\textsuperscript{42}

Although some may argue that the absence of formal rules serves parties better than rigid, inflexible rules, in this case the MC PIP’s formal rules for bid protests would appear to have benefited the I-35W procurement, as to both the government agency and the private contractors. The timeline by itself would have clarified many issues, and allowed for a more thorough presentation of arguments. While nothing in the MC PIP would necessarily have required a different outcome of the award protest, the remedies are more explicit than current Minnesota law. The clarity of potential remedies would better permit bidders to evaluate the actual worth of engaging in the protest process.

Conclusion

Our nation now faces its worst economic ills since the Great Depression. One solution to cure these ills is to begin a public works program the likes of which we have not witnessed since FDR’s New Deal, or when Republican Dwight Eisenhower and Democrat Al Gore, Sr., worked together to build the interstate highway system. Collaborative, bipartisan efforts are needed to find effective ways to repair, replace, and upgrade our public infrastructure—bridges, highways, neighborhood streets, airports, public buildings—in order to create jobs and revive our economy.

The aftermath of the I-35W bridge collapse illustrates many of the issues involved in public infrastructure procurement. In the final analysis, the process of determining which method of contracting optimizes the achievement of best value would appear to be best served by adopting uniform laws similar to the MC PIP. With the help of such a time-tested, uniform approach to procurement policy, we will be better prepared to meet the challenges posed by public infrastructure projects in the years ahead. \textsuperscript{43}
8. MC PIP § 5-502(2).
10. MC PIP § 3-103(5). Other methods included in the MC PIP are design-build-operate-maintain and design-build-finance-operate-maintain. These methods are evaluated the same way as a design-build procurement would be, with the addition of evaluation criteria related to the operation, maintenance, and finance aspects of the procurement. (See MC PIP §§ 5-102(5), (6); 3-103.) The MC PIP also recognizes a delivery process for operations and maintenance procurements, a subject outside the scope of the present discussion.

11. See MC PIP § 5-103.
12. Id.
13. MINN. STAT. § 161.3414.
14. MINN. STAT. § 161.3416.
15. MC PIP § 3-107.

16. As a practical matter, such a short time period allowed only for the elimination of certain causes, e.g., terrorism, collision by a boat or barge, etc. Thus, a desire for a new design, explicit or otherwise, could be understood as an attempt to avoid the potential errors in the first bridge.

17. MC PIP § 4-101.
18. MnDOT had a reimbursement schedule that paid the contractor $200,000 for each day the contract was completed early. Here, the winning proposal had the longest allowable schedule of 437 days until “substantial completion,” which projected to December 2008. The bridge opened on September 18, 2008, with a completion time of 339 days. Combined, the contractor earned nearly $260 million. This consists of a $20 million bonus for early completion, paid on top of the $7 million bonus for “on-time” completion and the $233 million original price proposal. The next alternative proposal had government out-of-pocket expenses of approximately $184 million if completed as proposed, roughly $76 million less. And this figure does not include a reported incentive for not requesting a change order worth millions of dollars.

19. See MINN. STAT. § 161.3426.
20. The “quality” criterion consisted of the following subcategories: experience and authority of key individuals, extent of quality control, safety, measures to evaluate performance in construction. The “aesthetics/visual quality” criterion consisted of the following subcategories: visual enhancements to the structure, and involvement of the public after letting. The “enhancement” criterion consisted of only one subcategory, geometric and structural enhancements. The “public outreach” criterion consisted of the following subcategories: impacts to the public and approach to communications.

21. Removing these categories would not change the ultimate outcome, which leads to the conclusion that the technical improvements were valued by the statutory formula as worth more than $71 million. Indeed, even valuing time at the full rate determined by MnDOT ($400,000 per construction day) would not alter the outcome in this case.

22. MC PIP § 3-103.
23. MC PIP § 3-103(5).
24. MC PIP § 1-103(7).
25. Id.
26. MC PIP § 3-601.
27. The first filing was within 24 hours, as directed by the RFP. Ambiguity in the actual deadline to protest led to a six-day extension.

28. Officials within Minnesota’s Department of Administration served as an administrative appeal panel, reviewed the MnDOT procedures, and made a recommendation to the commissioner of transportation to affirm the earlier decision and award the contract. The recommendation was accepted and the award was made the very same afternoon.

29. The I-35W bid protest did raise some meaningful issues regarding data disclosure and transparency, including how to protest the award without the relevant information used to make the award. MnDOT also recognized the Government Data Practices Act to prohibit disclosure of competing proposals and their evaluation until after actual award of the contract. As currently written, the MC PIP does not provide for protective orders, and similar procedures in protests would not modify the result in Minnesota. In the arena of public transportation, issues of confidentiality can broach national security concerns as government officials try to limit public dissemination of knowledge regarding technical failures.

30. For a further critique of the bid protest procedures and an argument for its chilling effect upon contractors, see Dean B. Thomson, Mark Becker & Jeffrey Wieland, A Critique of Best Value Contracting in Minnesota, 34 WM. MITCHELL L. REV. 25, 57 (2007).
32. Id.
33. Id. The award or solicitation may continue if a written determination is issued stating that continuing is necessary to protect substantial interests of the purchasing agency. MC PIP § 9-107.
34. Id.
35. MC PIP § 9-107.
36. Id. However, agency decisions related to the following MC PIP sections are considered final and conclusive unless they are clearly erroneous, arbitrary, capricious, or contrary to law: § 3-102(6) (Competitive Sealed Bidding, Correction or Withdrawal of Bids; Cancellation of Awards); § 3-103(1) (Competitive Sealed Proposals, Conditions for Use); § 3-103(7) (Competitive Sealed Proposals, Award); § 3-105 (Sole Source Procurement); § 3-106 (Emergency Procurements); § 3-107 (Special Procurements); § 3-301(1) (Responsibility of Bidders and Offerors, Determination of Non-responsibility); § 3-303(3) (Substantiation of Offered Prices); § 3-401 (Types of Contracts); § 3-402 (Approval of Accounting System); § 3-403(2) (Multi-Term Contracts, Determination Prior to Use); and § 5-103 (Choice of Project Delivery Methods).
37. MC PIP § 9-108.
38. MC PIP §§ 9-104; 9-105.
39. MC PIP § 9-104.
40. MC PIP § 9-105.
41. MC PIP §§ 9-105(b).
42. MC PIP § 9-105(a).
The Procurement Process in Canada: Necessity of Canadian Counsel

BY DENIS CHAMBERLAND

Canada is the United States’ closest and largest trading partner. The Canadian federal government’s largest buying departments are the Ministry of National Defence, and Public Works and Government Services Canada (PWGSC). Together these two agencies buy some $14 billion (CDN) worth of goods and services annually, mostly from Canadian and U.S. companies. Many of the U.S. companies that do business in Canada are familiar with the procurement rules in various jurisdictions in the United States. What these companies sometimes fail to appreciate—to their detriment—is that the legal procurement framework in Canada in the areas that matter most to bidders is nothing like that in the United States.

Guidelines, Regulations, and Trade Agreements

The public sector in Canada is subject to a number of trade agreements, including chapter 10 (procurement) of the North American Free Trade Agreement (NAFTA); the World Trade Organization (WTO) Agreement on Government Procurement; and chapter 5 (procurement) of the Agreement on Internal Trade (AIT), which was signed by the federal government, the provinces, and the territories in 1995 for the purpose of eliminating trade barriers within Canada. Under the AIT, several provinces have passed annexes that push down the procurement requirements of the agreement to the so-called “MASH” sector, which includes municipalities, local boards, social services organizations, hospitals, and universities, among other entities. Again, the idea is to free up the markets and promote the flow of goods and services across borders.

In addition, most major Canadian jurisdictions have in place legislation, including supplementary regulations and guidelines, that governs the acquisition of goods and services. For instance, at the federal level, Treasury Board of Canada’s contracting policy sets out the framework for doing business with the federal government. This is supported by the Standard Acquisition Clauses and Conditions Manual, which provides information on terms and conditions commonly used in the contracting process by the federal government and PWGSC, and by the Government Contracts Regulations, which are also issued by the Treasury Board of Canada.

The Common Law

Beyond the contracting framework, the laws that governed specific procurement opportunities were much the same in Canada and the United States—until 1981. The law of contracts applied, with the result that a bidder could withdraw its proposal at any time until it had signed a contract with the buyer, subject of course to losing its bid bond (where one had been submitted).

In R. v. Ron Engineering & Construction (Eastern) Ltd., [1981] 1 S.C.R., the Supreme Court of Canada turned the law upside down by holding that the release of a tender document by a buyer would (in most cases) constitute an offer to prospective bidders. In turn, the submission of a proposal by a supplier would constitute an acceptance, which could not be withdrawn or cancelled for the period of time specified in the tender document. Together, such offer and acceptance would create the “bidding contract.” While the case established the fundamentals of the so-called Contract A/Contract B analysis in tendering law, almost all of the higher court decisions since Ron Engineering have sought to balance the rights and obligations of the parties to the bidding process. Seminal Supreme Court of Canada decisions were issued as recently as 1999, 2000, and 2007.

Procurement Strategy

The result of having an activist Supreme Court of Canada in procurement law issues has been to make of the law an important strategic consideration in the bidding process in Canada (a regrettable development, some would say). This is highlighted at various stages of the procurement process, including the following:

1. Procurements for major projects typically require a great deal of preparation and forethought by buyers. The complexities may be such that it may even be desirable for a prospective bidder to proactively contribute to shaping public-sector thinking long before the tender document is issued, or conceived, in some cases. There is always the risk, however, of becoming overly involved in the prerelease process and being found to be in a conflict of interest position. Understanding the law on the extent of permissible involvement by a prospective bidder offers two significant benefits: first, it provides the buyer with a level of comfort that problems will not surface after the closing of the bids; and second, the supplier that invested considerable time up front working with the buyer—often at no cost to the buyer—will know that its efforts will not be defeated by legalities.

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2. Whether in Canada or the United States, buyers look for compliant bids. What is different in the application of the common law in Canada, however, is that buyers are legally obligated to disqualify noncompliant bids. The only discretion is in the area of bid clarification, which is acceptable (but not bid reformation). Understanding the legal requirements can often make the difference between submitting a bid that can be clarified and one that cannot.

3. Where a buyer awards a contract to a noncompliant bidder, in Canada other bidders are automatically entitled to challenge the buyer’s decision on the basis that the buyer owes legal obligations to all the bidders equally (pursuant to Contract A). Here, again, a bidder well informed about the legal requirements can promptly move to challenge the buyer’s decision, and, in some jurisdictions, have it overturned within three months.

4. Finally, in some cases, it is even possible to bring about the reversal of a decision that is about to be announced by a buyer, in favor of another bidder, based entirely on representations made to the buyer about the workings of the legal requirements applicable in Canada. Since many public agencies in Canada remain largely unaware of the public-sector legal requirements, a small amount of information can sometimes yield significant results.

A U.S. company interested in doing business with Canadian buyers would be well advised to include Canadian procurement counsel as an integral part of its bid team. Counsel’s understanding of Canadian procurement laws and the local business and operational needs of buyers will provide such a company with a clear advantage over its competitors.

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Why Am I Feeling Unstable?

By Pensive Poser, Esquire

Why am I feeling unstable! This question can be answered accurately at many different levels. But my particular source of discomfort presently comes from a specific statement over which I have long puzzled.

That statement in its various kindred forms has appeared in multiple best value solicitations that I have happened upon over the years. It appears after the solicitation describes the evaluation hierarchy of factors and, in its most frequent iteration, goes something like this: “Notwithstanding the above, to the degree that the non-price factors are evaluated to be equivalent, price will become more important.”

I have often wondered, could this literally be true? Is this really setting up a floating scale in which the price factor may become more important in the evaluation than is otherwise set out? Surely not, I have always thought, because, if that were true, it would violate the requirements that the relative weight of all factors be specified in the solicitation and that the evaluators adhere to those weights. Otherwise, one must wrestle with such imponderables as, just how equivalent do the other factors have to be before price gets more weight? Just how much extra weight is price getting? Is the increased weight now making price relatively more important than the other factors? What if price is equivalent or nearly so—how much more importance does it get then? And, how can offerors possibly be expected to handicap for these shifting relative weights of the factors when putting together their offers?

Fearing that such imponderables would overtax my already overly stressed mental faculties, I have always assumed that the statement did not really mean what it said, but was merely a clumsily written statement of the obvious—i.e., if all other factors but one are equal, the remaining factor, no matter what its relative importance, becomes the deciding factor. Of course, this explanation is not wholly satisfying in a society such as ours that stresses equal rights, equal opportunity, and equal billing. Why is only price singled out for this special notice? Why are not offerors also put on notice that, for example, “to the extent nontechnical factors are evaluated to be equivalent, the technical factor will become more important” and “to the extent nonperformance factors are evaluated to be equivalent, the past performance factor will become more important”? If I may personify, why does Mr. Price get the special treatment, and Mr. Technical and Ms. Past Performance and their siblings get slighted? It’s just not right. It’s un-American.

Not wanting to believe that the solicitations of our own government are un-American, I have simply repressed these thoughts and believed that the statement exalting price as becoming more important really doesn’t mean what it literally says, but instead means, “to the degree the other factors become equivalent, any one factor, whatever its stated relative importance, may become determinative in the evaluation.” But if this is what they mean, why don’t they just say that? For that matter, if that’s what they mean, do the writers of a solicitation think offerors are as addled as me and cannot figure that truism out for themselves? Not just un-American, but insulting, too.

You may be able to imagine my inner state of turmoil, then, when, while lounging on my sofa in my leisure time reading recent Court of Federal Claims decisions, I chanced upon some that did not treat the “price will become more important” statement as a clumsily crafted tautology, but as literally true and important to the legal analysis. The court in Serco, Inc. v. United States labeled such a statement as an “important caveat” that supported its ruling that the agency had not given price substantial enough weight in the evaluation. In Systems Plus, Inc. v. United States, the court used a similar statement to deny a protest on prejudice grounds by ruling, in part, that such a statement gave the contracting officer free-floating discretion to assign the weights to the evaluation factors.

So what is the thoughtful offeror to do when it sees such a statement in a solicitation, knowing that the statement might later tilt the evaluation against it? Must the offeror make a preemptive attack and protest such a statement prior to award, noting that it could be facing a sliding scale of factors that might later become infected by evaluator existentialism, upon pain of waiving any such objection? But how does our poor offeror know whether the statement will, instead, turn out to be beneficial to its interests if it is actually used to alter the weight of the evaluation factors in some pro-price, but otherwise undefined, manner?

Which all adds to my angst and leads me to query: Is this statement about price increasing in importance to the extent other factors are evaluated to be equivalent really necessary in best value solicitations? Would we all be better off without it? I wonder.

Endnotes

1. See, e.g., Serco, Inc. v. United States, 81 Fed. Cl. 463, 466-67

(continued on page 26)
remedy for them. Dan noted that there are few cases as to what remedy(ies) could be available for delays in commercial item contracts. As for delays caused by subcontractors, the Federal Circuit has held that a subcontractor’s inexcusable failure to perform does not constitute excusable delay on the part of the prime. Gen. Injectables & Vaccine, Inc. v. Sec’y of Defense, 519 F.3d 1360 (Fed. Cir. 2008).

Dan then discussed inspection and acceptance, noting that FAR 52.212-4(a) appears to reflect the U.C.C. “perfect tender” rule (2-601), but that the language in the FAR clause is slightly different. Although the clause at FAR 52.212-4(a) provides the government with postacceptance rights, it does not define them. The clause allows the government to require “repair or replacement of nonconforming supplies or reperformance of nonconforming services at no increase in contract price,” but does not say whether this is a postacceptance right or whether rejection or replacement must occur prior to acceptance.

Dan then turned to termination for convenience (T/C), saying that because this is primarily a question of pricing, he would defer to Greg Bingham. Greg addressed FAR 52.212-4(l), “Termination for the Government’s convenience.” In pertinent part, the clause reads as follows:

Subject to the terms of this contract, the Contractor shall be paid a percentage of the contract price reflecting the percentage of the work performed prior to the notice of termination, plus reasonable charges the Contractor can demonstrate to the satisfaction of the Government[,] using its standard record keeping system, have resulted from the termination.

Regarding termination for default (T/D), Greg noted that although FAR 12.403(a) does not require contracting officers to apply the provisions of FAR Part 49 to “terminations for cause” (and, in fact, it says that the requirements of Part 49 “do not apply when terminating contracts for commercial items”), FAR 12.403(a) allows them to “use Part 49 as guidance” (to the extent it does not conflict with FAR 52.212-4). Moreover, “[p]rocedurally defective termination for default [is] not automatically converted to termination for convenience; Contractor must establish prejudice.” BearingPoint, Inc. v. United States, 82 Fed. Cl. 181 (2008). For the most part, neither the Cost Accounting Standards (CAS) nor the Cost Principles (FAR Part 31) applies to contracts for commercial items.

Meeting information: The CP/S Committee generally meets the second Thursday of the month (lunch served) in the Washington, D.C., office of Wiley Rein LLP, 1776 K Street, N.W., Washington, D.C. 20006-2304. Teleconferencing connections are available to those outside the Washington area. Contacts: Co-chairs Paul S. Ebert, (703) 933-3241, or e-mail pebert@imshealth.com; Tony G. Fuller, (703) 923-8688, or e-mail tfuller@beersandcutler.com; and Kevin J. Maynard, (202) 719-3143, or e-mail kmaynard@wileyrein.com. For more information on this and other committees, visit the Section Web site at www.abanet.org/contract/home/html. Click on “Substantive Committees” on the left-hand navigation bar.
Research and Development and Intellectual Property Committee

October 2, 2008: Cochair Bob Huffman opened by discussing the then-tentative ABA-CLE Update on Rights in Technical Data and Computer Software panel, which was held on November 6, 2008. Bob served as moderator, with Bill Adams, Richard Gray, and Ralph Nash as panelists. After the meeting the ABA Center for CLE announced the panel, listing 11 topics as among those to be covered. The minutes of the panel will summarize the material covered.

Bill then discussed several sections of Title VIII of the NDAA for FY 2009 that concern intellectual property. Section 822 (Technical Data Rights) requires the secretary of defense to “issue policy guidance with respect to rights in technical data under a non-FAR agreement [within] 270 days after the date of the enactment of this Act.” Section 822 also requires the secretary of defense to “submit to the Committees on Armed Services . . . a report on the implementation of the requirements in [10 U.S.C. § 2320(c)] for the assessment of long-term technical data needs to sustain major weapon systems.” Section 824 concerns “[m]odification and extension of the pilot program for transition to follow-on contracts under authority to carry out certain prototype projects.” Section 887 pertains to “[r]eports on the implementation of earned value management at [DOD].” This includes, among other matters, retention of fees from licensing IP.

Bob then discussed four recent decisions. In Blueport Company LLC, the Federal Circuit affirmed the CoFC’s dismissal of Blueport’s claims for copyright infringement and Digital Millenial Copyright Act of 1998 (DMCA) violations for lack of jurisdiction, in that the government had not waived sovereign immunity. The copyrights in question were on a software program and source code written by an Air Force sergeant at his own initiative and at home on his own computer. Sergeant Davenport, having refused to turn over the source code to the Air Force, assigned all of his rights in the program to Blueport. The Air Force then contracted with SAIC to modify the object code so as to extend its expiration date, thereby allowing the Air Force to continue using the program “despite Davenport’s refusal to provide the source code.” The CoFC, affirmed by the Federal Circuit, found jurisdiction lacking under both 28 U.S.C. § 1498(b) and DMCA. Under the former, there was no “right of action on any copyright owner or any assignee of such owner with respect to any copyrighted work prepared by a person while in the employment or service of the United States where the copyrighted work was prepared as a part of the official functions of the employee.” Under the latter, neither DMCA nor the Tucker Act expressly waives sovereign immunity.

In Distributed Solutions, Inc., and STR, L.L.C. v. United States, the Federal Circuit reversed the CoFC’s dismissal of plaintiff-appellants’ bid protest for lack of jurisdiction and remanded the case. DSI and STR protested rejection of their offers by SRA, the government’s integrator for software in development of a program. The CoFC dismissed the protest because, among other things, SRA was not a purchasing agent for the government. In reversing that decision, the Federal Circuit held that “the contractors [were] not contesting the SRA’s award of the subcontracts. Rather, they [were] contesting the government’s decision to task SRA with awarding subcontracts for the purchase of software instead of procuring the software itself through a direct competitive process.” Among other things, the Federal Circuit cited the definition of “procurement” in 41 U.S.C. § 403(2).

In TDM, L.L.C. v. United States and Donjon Marine Co., the CoFC denied the government’s motion for partial summary judgment, which was based upon lack of government authorization to infringe under 28 U.S.C. § 1498(a). The suit arose from U.S. Army Corps of Engineers (USACE) contracts for dredging and processing contaminated materials from navigation channels; Donjon was one of the contractors. The contract clause in question, common to all 18 contracts involved, was FAR 52.227-1, implementing 28 U.S.C. § 1498(a) (the Authorization and Consent Clause). Of the contracts, 13 required the contractor, among other things, to “submit and receive USACE approval of the proposed process before contract award.” The other five required “the contractor to use the OEN (Bayonne, NJ) site or to seek prior approval from USACE to select an alternative site.” On that basis the court found “that the Government authorized and consented to the alleged infringing activity for each of the eighteen contracts at issue.”

In CANVS Corp., the ASBCA held that it lacked jurisdiction to hear the appeal from the Army’s deemed denial of a claim for unlicensed use of a patent involving night vision goggles. The appellant was a third party, not the contractor, and therefore ineligible to file the appeal.

Finally, Bob turned to the Prioritizing Resources and Organization for Intellectual Property Act of 2008. He noted that, among other matters, the Act created the position of IP coordinator (czar) to coordinate agency anti-counterfeiting initiatives. The post of IP coordinator will be in the White House instead of in the Department of Commerce, as it is at present. Kirsten Koepsel further reported on the Act.

Meeting Information: The R&D/IP Committee generally meets the first Thursday of the month (lunch served) at the Washington, D.C., office of Akin Gump Strauss Hauer & Feld LLP, 1333 New Hampshire Avenue, N.W., Washington, D.C. 20036-1565. Teleconferencing connections are available to those outside the Washington area. Contacts: Cochairs Anne M. Donohue, (703) 227-7062 or e-mail anne_donohue@sra.com; Robert K. Huffman, (202) 887-4530 or e-mail ruffman@akingump.com; and Herman D. Levy, (703) 698-5246 or e-mail hdlledeor@aol.com. For more information on this and other committees, visit the Section web site at www.abanet.org/contract/home.html. Click on “Substantive Committees” on the left-hand navigation bar.
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with a favorable policy and funding environment for biofuels, clean coal, or hydrogen, the transition to new fuels will be slow. Major technologies historically have had an “adoption lag.” In the energy sector, a recent study found that it takes an average of 25 years for a new production technology to become widely adopted.6

It is likely that ESPC will continue to be a popular contracting vehicle for federal agencies to achieve anticipated fuel efficiencies in an environment of budgetary shortages.7 This is a compelling reason why there will be a continuing and unabated need for the government to both upgrade and make more efficient its energy systems.

The federal government has recognized the need to take extraordinary measures to reduce its use of energy. Moreover, as noted above, despite the recent and precipitous decline in oil prices, no one can seriously disagree that the availability of oil, gas, and coal is finite, or that the United States faces increasing competition for these resources. ESPC is one of the tools that the government has used, and will likely continue to use, to accomplish these ends.

I will discuss briefly the potential impact of the so-called “subprime lending crisis” and the “credit crunch,” and their effects on available credit to finance ESPC agreements.8 I will discuss this and the basics of ESPC contracting and some of the legal issues that have arisen and may arise in connection with the utilization of this contract modality.

Some commentators have expressed the view that when ESPC agreements “are being used more frequently for larger and more lucrative government projects, challenges and disputes from the implementation and negotiation of these contracts will become an issue in the near future.”9 In fact, there are few directly relevant, reported cases interpreting statutes that implement or impact ESPC, or the regulations relating thereto.

One recent case decided by the U.S. Court of Federal Claims, Enron Federal Solutions, Inc. v. United States10 (hereinafter EFSI) may offer some useful insights. I will discuss this in detail. Although it did not involve an ESPC agreement per se but rather a “utility privatization” contract—the purpose of which was clearly to engender energy savings at an Army facility—EFSI raises interesting questions about what happens when problems arise in an ESPC scenario due to a default termination.

Executive, Legislative, and Statutory Background

ESPC is a relatively recent development. Although federal agencies have had the authority to enter into performance-based contracts since 1985, it was not until 1995 that Congress authorized “shared energy savings agreements” with the passage of the Consolidated Omnibus Budget Reconciliation Act, Public Law No. 99-272.11 Within only two years of the enactment of that statute, agencies had utilized the ESPC device to draw more than $1 billion in private sector investment for the purpose of improving the energy efficiency of a great variety of federal facilities.12 Since that time, that dollar value has increased steadily.13 Ironically, this seemingly salutary legislation had to overcome a “sunset” provision a few years ago, but that provision was subsequently repealed with follow-on legislation extending the agencies’ authority to utilize ESPC until September 30, 2016.14 Given the current national energy and economic circumstances, ESPC in the federal government appears to be here to stay.

Interestingly, as the authors of a comprehensive study evaluating ESPC noted as recently as 2003:

Despite the Congressional and Presidential directives to use ESPCs, some agencies have been reluctant to do so. Decision makers in these agencies see no reason to enter into long-term obligations to pay interest on borrowed money out of their own operating budgets if instead Congress will grant them appropriations to pay for the improvements up front.15

The landscape has changed dramatically since these comments were made. The United States is experiencing a current period of extremely high deficits that will only be exacerbated by the $700 billion “bailout/rescue.” Even with a change of presidential administrations, there will be continued financial demands to support the conflicts in Iraq and Afghanistan. These factors, coupled with the temporarily abated, but inevitable, rise in energy costs and probable lower tax revenues in a stalled economy, make it highly unlikely that Congress will appropriate sufficient funds simply to upgrade existing, functioning—albeit inefficient—heating, cooling, and lighting systems. As such, congressional funding may not be a particularly realistic way of meeting the congressionally mandated goal of the federal government’s reducing its energy usage by 35 percent from the 1985 baseline level of energy consumption by 2010.16

Industry Views on Effects of Recent Events on ESPCs

ESPC industry representatives who are knowledgeable about financing and bonding of such contracts have told me that the growth of ESPC utilization by federal agencies has continued steadily. They report, however, that companies providing financing for these projects are becoming more stringent in their analysis of their potential profitability. Moreover, these insiders note that the larger capitalized energy saving contractors (ESCOs) will enjoy a competitive advantage in terms of availability of financing.17

These industry representatives report that availability of financing has not necessarily diminished but, rather, finance companies are requiring more information and stringent qualifications from their ESCOs. Additionally, the “spreads” between competing companies, in terms of differences in basis points of interest, have become wider. Similarly, whereas before the “credit crunch” companies had been willing to hold their rates of interest for relatively long periods of time while federal agencies and the ESCOs negotiated the final terms of their agreements, these com-
Energy Savings Performance Contracting is a contracting procedure in which a private contractor evaluates, designs, finances, acquires, installs and maintains energy savings equipment for a client, and receives compensation based on the performance of that equipment. The conditions of the contract determine the level of compensation to the contractor, with the remainder of the savings retained by the client.18

Selection of the ESCO

Essentially, ESPCs work as follows: Selection of an energy savings contractor in the federal arena can occur in a number of ways: (1) an ESCO responds to a specific request for proposal (RFP) issued by a particular federal entity; or (2) an ESCO can approach a federal facility and discuss conducting an audit of the facility's energy consumption with the idea of developing a proposal for energy savings; or (3) an ESCO can be prequalified by either the Department of Energy (DOE) for eligibility in its so-called “Super ESPC” program, or under the auspices of the Department of Defense (DOD). Where prequalified, the ESCO, in the case of DOD, can be recommended, along with a few others, to a DOD facility, or, under the Super ESPC program, may be awarded an indefinite delivery/indefinite quantity (IDIQ) contract, and receive particular task orders under that IDIQ contract.19

While the first two selection methods are self-explanatory, perhaps the most common way that ESPC services are procured is through a federal prequalification program such as that of the DOD (by far the largest federal user of ESPC services)20 and the DOE. The benefit to various federal entities under the prequalification programs is that the process of selection becomes less costly to the agencies because the selection process is streamlined, dramatically reducing the time it takes to select an ESPC and begin the process of energy savings. DOE asserts that under its Super ESPC program, in addition to providing substantial oversight for the various agencies, this service can reduce procurement time from two to three years to as little as four months to one year.21

Under the DOD program, the Army, as lead agency for DOD on ESPC contracting, initiates a notice in the FedBiz Opps soliciting firms that wish to be considered for prequalification for future ESPC projects. Once selected via a review of their statement of qualifications by a qualification review board (QLB), the firms are qualified for a year. From the list of prequalified firms a “technical board” will select no less than three but no more than five firms deemed capable of performing a particular project. These firms will be solicited to provide abbreviated price and technical proposals. Thereafter, the technical board will rank the offerors, making a recommendation to the contracting officer (CO) and providing a rationale for selection. If the CO approves, he or she will enter into negotiations in accordance with standard acquisition procedures. This does not, however, preclude the CO from making multiple awards. The awardee(s) will be required to provide all of the management, labor, material, equipment, and operations and maintenance services during the term of the agreed contract.

The DOE prequalification process works similarly to DOD’s, and both agencies utilize IDIQ “master” contracts, issuing task orders up to a defined limit.22

The factors on which ESCOs are selected for prequalification are straightforward, and include: (1) previous experience and demonstrated technical ability, with proven success in energy savings as a major factor; (2) financial viability and resources to perform; (3) the capacity to develop energy baselines via energy audits that are technically acceptable; and (4) having qualified staff, including subcontractors, for performance of all that is necessary for a completed project.23

Energy Savings—the Key to ESPC Success

Obviously, the key to the success of any ESPC agreement is the savings of energy over the term of the contract, from which (a) all capital expenditures are paid, and (b) the ESCO secures its profit. A critical first step is the establishment of a “baseline” during the audit of energy usage before the implementation of capital changes. This audit, known as a detailed energy survey (DES), is described as follows:

The DES is the ESCO’s investment-grade audit of facilities and energy systems at the project site. The DES augments, refines, and updates the preliminary site survey data and provides the information needed to establish the energy and O&M [Operation and Maintenance] baselines and update the feasibility analyses of the ECMs [energy conservation measures] under consideration. Such information is also used to verify or adjust the estimated annual cost savings and confirm the contractor’s ability to structure a project with an acceptable term, with guaranteed annual cost savings that cover the firm-fixed-price contractor payments. The DES is the basis for the revised technical and price proposals.24

Development of Detailed Energy Survey

It should be noted that a prospective ESCO undertakes a DES at no risk to the agency, but these costs are recoverable by the ESCO if the agency decides to go forward on the recommendation of the ESCO. As the DOE points out in its guidance:

The Super ESPCs were structured to allocate the greater share of the business risk to the ESCO. An ESCO may spend more than $1 million on developing initial and final proposals for a
$3 million project, at no obligation to the agency until the delivery order award is signed. The ESCO can recover project development costs in the implementation price only if the project is ultimately awarded.25

(Emphasis added.)

**Development of Revised and Final Proposal**

Once the DES is completed and the baseline established, the parties will negotiate the package of energy conservation measures (ECMs) to be included in the scope of work, and develop and agree to a revised and final proposal as follows:

The ESCO integrates findings from the DES and the results of the financing acquisition with the requirements stated in the IDIQ and DO [delivery order] RFP to produce the final proposal. Findings of the DES are usually submitted as part of the final proposal. The proposal addresses ECMS considered, their feasibility, energy savings calculations, rationale for ECM selection, costs to implement each ECM with detailed backup information, and annual cost savings of each ECM with detailed supporting data.26

These energy savings are guaranteed by the ESCO, and the annual delta of savings obtained over the baseline is the source from which the ESCO recovers its capital expenditures for the installed and constructed improvements to the project’s energy systems as well as its potential profit. If there are savings beyond an ESCO’s costs and profit, these may be recovered by the federal agency. On the other hand, if the ESCO does not meet its guaranteed savings, through no fault of the particular agency, such losses are absorbed by the ESCO.

**Financing, and Operation and Maintenance**

A principal benefit to a federal agency in entering into an ESPC agreement is the avoidance of any initial outlay of funds for the purchase of material and permanent improvements to the facility from which savings are derived. As is well known in this field, the simple expedient of replacing all of the light bulbs and their fixtures with more energy efficient materials may result in a major portion of the energy savings. Under an ESPC agreement, the contractor normally finances all of these out-of-pocket costs. These costs, and the interest costs, are factored into the ESCO’s projected costs as well as its profits over the life of the contract. The ESCO’s obtaining of financing must be at arm’s length. As the DOE states in its guidance:

> Modifications made to the Super ESPC prime contracts in December 2004 require the ESCO to solicit competitive financing offers for the project in the commercial markets. The intent of this requirement is to ensure that the Government will receive the best possible overall value. The financing of a Super ESPC project is a contract between the ESCO and the financier, and it is the responsibility of the ESCO to obtain competitive offers, evaluate the offers, and make a selection based on their criteria for best value. The ESCO is required to document the process for the government.27

**Development of Acceptable Measurement and Verification of Energy Savings**

As important as determining the baseline of annual energy consumption is the development and agreement between the agency and the ESCO of an acceptable measurement and verification (M&V) program so that, as objectively as possible, energy savings can be calculated annually in a transparent and logical way. The DOE points out in its April 2005 guidelines:

> Careful consideration should be given to the final M&V plan, because it specifies how savings will be determined. The final M&V plan should specify the following for the entire contract term:
> - M&V methods to be employed
> - Measurements, calculations, and stipulations
> - Required content of the annual M&V report
> - Recurring M&V deliverables, e.g., reports required with each monthly invoice, if continuous measurements are performed
> - One-time M&V deliverables, e.g., the post-installation report
> - Responsibility for M&V activities, preparation of analyses, and documentation
> - O&M report requirements for each ECM (if required)28

**Length of Contracts**

Although by statute agencies are permitted to enter into contracts with ESCOs for upwards of 25 years so as to allow for amortization of costs,29 the repayment by an agency out of energy savings will be such that an ESCO will recover its costs of the improvements within the first 10 years after completion. During the performance phase of the contract, the ESCO agrees to maintain and operate the ECMS, which further reduces the agency’s costs but, almost as importantly, also better ensures the ESCOs that these upgraded energy systems are properly performing so as to protect their investment in achieving the guaranteed energy savings over the life of the contract.30

**Potential Problems and Pitfalls in ESPC**

There have been relatively few reported decisions relating to disputes arising out of ESPC agreements, and some of those have been issued in connection with nonfederal energy savings contracts. This may be due to the relative newness of these programs, as well as the fact that in the federal programs there is a strong emphasis on the notion that an ESPC agreement is a “partnership” between the agency and the ESCO, and alternative dispute resolution is strongly encouraged. Moreover, almost by definition, the projects are either turnkey or design-build, where the ESCO has control over both design and construction.

**Early Termination**

If an ESPC agreement is terminated early, for convenience or for default, what obligation does the agency have to pay for improvements? As noted above, the obvious reason for the length of ESPC agreements is to create a stream of sav-
ings sufficient to pay for substantial improvements via reason-
ably level payments. What if an agency was to shut down a portion of a facility, make major modifications or, more drastically, close a facility well within the term of the contract? Typically ESPC agreements contain schedules that will dictate payments to be made to the ESCO in the event of terminations for convenience before the full period of the contract. As one commentator notes:

By agreeing to enter into a federal government contract that contains a termination clause, a contractor relinquishes the common law formula [regarding the right to future lost profits] and acquiesces in the substitution of a formula under which profit is allowed only on the work actually performed to date. Other federal contracts, however, such as federal energy savings contracts entered into under the Energy Policy Act of 1992, often include termination schedules that provide for termination payment of specified amounts that the government is required to pay if it exercises a termination for convenience. Such amounts are usually sufficient to repay the entire remaining amount of the financing together with a set premium to compensate the lender for the early prepayment.31

This is not as automatic as it sounds, and there can be variables. Clearly, in order for an ESCO to generate the energy savings needed to both cover its costs and make its profit, it needs all of its ECMs to continue to be operational for the entire period of operation and maintenance. As a recent analysis of an ongoing ESPC contract points out, demolition of facilities, modification, and closure are not uncommon, particularly at military facilities. An author of a recent study of an ESPC agreement notes:

The ESPC concept makes an assumption that is not accurate—that facilities remain static for the term of the contract. With mission requirements constantly changing, requiring facilities to remain unchanged for 25 years is just not a tenable proposition. The following are the issues that have arisen affecting the ESPC program, and the implemented solutions that keep the program flexible and viable:

* * *

Demolition of facilities. . . . appropriate contractual adjustments must be made, as the installed equipment still belongs to the ESCO. Since the demolition is not the fault of the ESCO, the ESCO is allowed to continue to claim credit for the energy savings its work produced in the facility. The ESCO also turns over ownership of any equipment installed under the task order in the facility to the government at the time of the buyout, and the government can salvage or discard at its preference.

Government changes to facilities. The requirement to modify a facility is far more common than demolition. When facilities are changed and the changes impact what the ESCO has to maintain, there must be some adjustment. Since the government wants to maintain a single maintenance contractor for the facility, it makes the most sense to have the ESCO be responsible. . . . The first solution to this problem was to add funding to the contract to cover the change in maintenance costs. The contracting office made the determination that this was not an acceptable solution and that KAFB [the facility] could not add non-energy-related funds to ESPC. The KAFB’s final solution was to award a small service contract to the ESCO on a sole source basis for maintenance of changed requirements. These contracts, which are called Companion Service Contracts (CSC), have certain specific features that make them unique. First, they are tied to ESPC. The ESCO cannot use non-performance on the CSC as an excuse for not meeting energy savings requirements on ESPC. . . . The CSC allows KAFB to use the ESCO as an installer for HVAC equipment as well, which gives incentive to the ESCO to ensure the installation is done in the best possible manner to minimize maintenance problems.

When changes are made that only add equipment, all the new equipment falls under the CSC. When equipment that was covered under ESPC is removed, the government and the ESCO negotiate what can be covered of the new equipment under ESPC to maintain the same service level for which the ESCO is being paid. The remainder is covered by the CSC. This is advantageous to both the government and the ESCO. The government maximizes the advantage of the flat-rate service ESCP provides, and the ESCO gets newer equipment to maintain.32

Bonding the ESPC

 Virtually all federal procurement contracts involving construction require that the contractor provide both performance and payment bonds.33 When a surety provides such bonds, it traditionally looks to its “principal” to sign a general agreement of indemnity (G/A)34 that includes a right to look to any contract balance remaining in the contract for repayment of any costs incurred in completion of the project, in the case of default, or to pay the surety for any payment bond claims it is required to honor in the event the principal fails to pay its subcontractors or suppliers. In the case of an ESPC contract, however, there is no “contract balance” to offset the losses of the surety.

Additionally, the usual “obligee” under a performance bond is the government agency that has entered into the contract with the ESCO. The entity paying the ESCO for services, materials, and equipment, however, is the financing company that provides the funds for the construction. In the event of default, how does the finance company protect itself by ensuring that there is a surety to complete the work, and thereby complete the project so that the finance company will be repaid out of energy savings?

Although there is apparently no statute, regulation, or case law dealing directly and specifically with these issues, based on my discussions with representatives of the financing, surety, and ESCO communities, it is common practice for financing companies to have themselves named as “dual obligees” on the federal agencies’ Miller Act performance and payment bonds. It also appears that neither the sureties nor the agencies have objected to this practice of protecting finance companies as additional obligees in the event of an ESCO default.

Correspondingly, sureties will require the financing companies to create escrow arrangements that will enable
them to tap into the balance of funding necessary for completion of projects, and to reimburse them for payment bond claims paid out. This also ensures that there is appropriate coordination of the repayment to the financing company of the funds advanced as well as repayment to the sureties of any sums that they have expended on behalf of defaulted ESCOs. There do not appear to be any reported cases, however, that deal with instances of ESCO defaults, or litigation of disputes between the financiers of such projects and the sureties.

In the more traditional setting, disputes often occur with regard to who is entitled to the balance of contract funds. Both sureties and financiers of ESPC agreements should have a familiarity with the Federal Assignment of Claims Act and Anti-Assignment Act because those statutes impose severe restrictions on the assignment of the proceeds of government contracts.

My discussions with representatives of ESCOs also reveal that performance and payment bonds cover only the construction aspects of the ESPC, and in most instances specifically exclude the O&M aspects of performance. Some states and other owners may require what are known as “guaranteed energy savings bonds,” (GESBs), which may be put in place from year to year, may be in force for as long as four years, and are expensive and difficult to obtain. Moreover, there is no insurance or bonding product currently available to guarantee energy savings for any lengthy period, such as for 10 year or more. These GSEBs typically make up the difference between the energy savings that have been guaranteed in a given year and any shortfall in actual savings. Generally, the federal agencies do not require GESBs, but they may require corporate guarantees of a subsidiary’s performance or standby letters of credit.

Sparse Litigation Involving ESPC Contracts
As noted above, there are few reported cases involving ESPC agreements, and research reveals that those few cases are only marginally relevant. This is most likely due to federal agencies and ESCOs working out disputes during the course of long performance periods. Whether this situation will continue remains to be seen, especially in the context of the current “credit crunch,” the weakening U.S. economy, and expected increase in the use of ESPC.

The most interesting decision from the United States Court of Federal Claims (COFC), Enron Federal Solutions, Inc. v. United States, does not actually involve an ESPC agreement but rather is a “privatization” case. EFSI nevertheless offers some interesting insights.

The Enron Federal Solutions Case
In February 2008 the COFC granted the government’s motion for summary judgment, holding that EFSI, a subsidiary of Enron Corporation, essentially forfeited its right to recover some $11.6 million it had expended in capital improvements at an Army base in Brooklyn after it was default-terminated by the Army in the wake of Enron’s bankruptcy. The court determined that the inability of EFSI, due to that bankruptcy, to continue to perform the remaining eight years of maintenance and operation of the upgraded systems supplying electricity, natural gas, potable water, and wastewater services to the Army’s Fort Hamilton facility in the Borough of Brooklyn in New York City, constituted a material breach, depriving EFSI of any rights to recover for any of the expenses it had incurred prior to the default.

Factual Background
In 1999, EFSI entered into a “privatization” contract with the Army Corps of Engineers in which it agreed to take title to Fort Hamilton’s utility distribution systems and to maintain and operate those systems for 10 years. EFSI had the responsibility to “front” all of the expenses involved in upgrading the systems, including financing charges as well as paying for any necessary capital improvements over the course of the contract term, all for a fixed price of approximately $25.4 million. In return, the contract required the Army to make fixed monthly payments to EFSI that amortized the contemplated expenses of the upgrades and the anticipated costs of operating and maintaining the systems.

The Fort Hamilton contract with EFSI was a DOD initiative to privatize the utility systems of the various services under Defense Reform Initiative Directive No. 9, called “Privatizing Utility Systems,” issued on December 10, 1997. The parties agreed that EFSI had substantially completed the estimated $11.6 million worth of upgrades to the fort’s utility systems, and that the Army had paid more than $4.2 million to EFSI by the date of Enron’s bankruptcy filing. They also agreed that shortly after the bankruptcy filing, EFSI ceased operations and renounced the contract in bankruptcy court. EFSI was default-terminated on February 26, 2002, and its surety, Liberty Mutual, completed the project.

Denial of EFSI’s Certified Claim
The CO denied EFSI’s certified claim for approximately $10.5 million for three principal reasons: (1) that FAR § 52.241-10 (“Termination Liability” for utilities contracts) had no legal force or effect on the contract between the parties; (2) that EFSI was not entitled to recovery under the contract’s “Termination for Default” clause; and (3) that EFSI was not entitled to recover its capital improvement costs under common law breach of contract or restitution theories.

COFC Grants Government’s Summary Judgment Motion
After EFSI brought its action in the COFC, the court granted the government’s motion for summary judgment. The court rejected EFSI’s contention that the government was required to pay for the improvements regardless of the basis for termination because it had contractually agreed to pay for them, holding that the “Christian Doctrine” did not operate to incorporate certain clauses, including FAR § 52.241-10, into the parties’ agreement.

For the court, the fundamental consideration in its
analysis of EFSI’s claims was that they were based on a privatization contract in which the Army was not merely purchasing the various components of the contracts, such as new boilers, but was also buying the materials and labor involved in the upgrade of the utilities systems, as well as 10 years of utility services. The court took the position that the contract was “not a construction contract or a contract for the sale of goods.” According to the court, the intent of the contract was to “shift the risk of capital improvements onto the contractor,” and the court found that, despite the parties’ agreement that EFSI has “substantially completed” the capital improvements portion of the contract, EFSI’s failure to complete the 10-year operation and maintenance portion was a material breach that precluded recovery for the value of the improvements, which reverted to the Army. 

**Relevance of ESPC Contract to Privatization Contract**

Because EFSI is not strictly an ESPC case, but rather deals with a privatization contract, it is hard to assess its precedential or persuasive authority. Nevertheless, there are many similarities, including especially the fact that both types of agreements require significant private capital outlays coupled with an extensive period of operation and maintenance. In the instance of default terminations during the postconstruction performance period, parties will naturally draw comparisons to the EFSI case.

**Bid Protest: Johnson Controls**

In 1999, Johnson Controls, Inc., protested the award of six ESPC DOE contracts at the National Gallery of Art and National Agricultural Library to other prequalified ESCOs in response to an RFP under a fixed-price, IDIQ procurement. Johnson complained that it was not selected for an award because the agency unreasonably downgraded its technical proposal in the evaluation of the ECM descriptions and its projected energy savings. The RFP provided that “technical factors were considered more important than price factors.” After discussions and submission of best and final offers (BAFOs), Johnson’s proposal was deemed technically inferior because the contractor had initially failed to submit certain important data and then after discussions produced data that were unreadable, among numerous other deficiencies. As the General Accounting Office (now the Government Accountability Office) (GAO) noted:

> Our Office will question an agency’s evaluation of proposals only if it lacks a reasonable basis or is inconsistent with the RFP’s stated evaluation criteria. DAE Corp., Ltd., B-257185, Sept. 6, 1994, 94-2 CPD ¶ 95 at 4. Agencies are not obligated to afford all-encompassing discussions, but are only required to lead offerors into the areas of their proposals that are considered deficient. Stone & Webster Eng’g Corp., B-255286.2, Apr. 12, 1994, 94-1 CPD ¶ 306 at 11. We conclude that DOE’s discussions with Johnson Controls were meaningful and that its evaluation was reasonable. 

The GAO determined that:

> The RFP stated that technical factors were more important than price, and Siebe’s proposal received a higher technical rating and its total price was lower than Johnson Controls’. Since, as discussed above, both the technical evaluation of Johnson Controls’ proposal and the price analysis of all BAFOs were reasonable and consistent with the stated evaluation scheme, we conclude that the award decisions were reasonable.

Leaving aside the particular analysis of the technical proposals, the criteria of the RFP and how the evaluators and source selection authority arrived at the decision not to award to Johnson Controls, this is not a remarkable decision, aside from the fact that it involved an ESPC contract. Yet one commentator states that “an ESPC award is more likely to be challenged on the basis of technical [evaluation] as compared to more standard commercial procurements.”

This is a fairly self-evident proposition. One of the essential elements of ESPC contracts is their “design-build” aspect. Of necessity, evaluation of responses to ESPC RFPs is going to involve an assessment of the “technical” aspects of such proposals. One of the advantages that federal agencies derive from ESPC contracts, beyond the fact that the ESCOs provide the up-front financing, is that the agencies do not have to determine how savings can be accomplished—that is the role of the ESCO. As such, competing parties are more likely to challenge awards on the basis of technical evaluations. Such challenges should be no more problematic than protests involving any other best value procurement, however, and the agencies’ decisions as to which proposals best meet their technical (cost savings) needs will continue to be afforded great deference by GAO. Moreover, while it makes sense to say that “as more ESPC contracts are awarded, more protests are likely to be based on alleged misevaluation of technical proposals,” it does not naturally follow that this is a hallmark of ESPC procurements as opposed to other “best value” acquisitions in which technical criteria may outweigh costs. Indeed, what is truly remarkable is the apparent low number of protests of ESPC procurements to date.

**Miscellaneous Other Cases Involving ESPC**

As noted earlier, although this does not purport to be an exhaustive exposition of every reported case involving ESPC or similar type contracts (either federal, state, or private), what appears remarkable is the paucity of published decisions that involve any analysis of the statutes or regulations.

**EUA Cogenex Corp. v. North Rockland Central School District**

EUA Cogenex Corp. v. North Rockland Central School District relates to a New York State energy services lease agreement (ESLA), wherein the contractor agreed to install and maintain certain energy savings equipment and share in the ultimate cost savings. When the contractor’s guaranteed savings did not pan out, the school district sued for breach of contract and other causes of action. There
was a significant amendment to the contract and the district court was asked to decide whether the individual who signed the amendment on behalf of the school district was authorized to do so, or, alternatively, whether the school district ratified the actions of its agent. Thus, the case is not really an analysis of a performance-based energy savings contract, but merely involves such a contract and issues not germane to how energy savings-type contracts are to be interpreted.

Rondout Valley Central Valley School District v. Conoco Corp. Rondout Valley Central Valley School District v. Conoco Corp.56 involved a guaranteed savings energy management agreement between a school district and Conoco Corporation, which had been a wholly-owned subsidiary of the Boston Edison Company. When Conoco went into bankruptcy, the school district sought to pierce Boston Edison's corporate veil to recover damages for breaches of contract and warranty involving failed cogeneration units and abandonment of operation and maintenance obligations, and for other damages. The opinion specifically deals with whether the school district's economic expert should be permitted to testify regarding his opinion on damages. The case offers little by way of analysis of the interrelationship of owners, savings performance contractors, financiers or sureties.

Barrett v. Johnson Controls, Inc. Barrett v. Johnson Controls, Inc.57 is a case that involves an ESPC agreement, but, like the other decisions cited above, does not provide much analysis of the workings of such contracts or the interrelations of the parties. Rather, it is a suit by a pro se plaintiff, who was claiming to be a qui tam relator under federal false claims statutes, against various qualified ESCOs. The decision involves little analysis of the ESPC statutes.

Conclusion

Despite the economic upheaval of the last six months, ESPC is likely to remain an attractive way for federal agencies to ensure capital improvements to their energy-consuming infrastructure systems. Given what we know of the incoming Obama administration's position regarding energy savings, it appears highly unlikely that the agencies will be relieved of their legal requirements to reduce energy consumption. Moreover, the "bailout/rescue" commitments of the outgoing Bush administration, coupled with the likely additional commitments that the Obama administration may have to make, will leave most federal agency budgets short of the necessary funds to dedicate to energy savings. This is likely to make ESPCs even more attractive to those agencies.

Although the cost of energy, particularly oil, has dramatically declined over the last few months, this does not appear to be a trend that will reverse anticipated increased worldwide competition for these increasingly scarce commodities in the long term. As a result, it does not appear that there will be any significant diminution of the pressure for federal agencies to do what they can to reduce energy consumption.

Additionally, although credit markets have tightened, the apparent overall success of ESPC contracting, as reflected by the paucity of substantial litigation between the federal agencies and ESCOs, should continue to make these agreements attractive. The agencies' familiarity with these contracts, coupled especially with their greater ability to measure actual cost savings, may, however, subject the ESCOs to increased scrutiny, and as a result may make performance requirements harder to meet. This could lead to more legal disputes and impact the attractiveness of this method of procurement. Only time will tell.
which to fund many capital projects, much less those related to energy improvement. Nevertheless, it is unlikely that the new administration will abandon Barack Obama’s campaign calls for energy conservation. Indications are that the Obama administration will do all that it can to improve America’s energy efficiency. In a recent, widely viewed interview on CBS’s 60 Minutes, on Sunday, November 16, 2008, the following exchange occurred between moderator Steve Kroft and President-Elect Obama:

(CBS) Kroft: When the price of oil was at $147 a barrel, there were a lot of spirited and profitable discussions that were held on energy independence. Now you’ve got the price of oil under $60.

Mr. Obama: Right.

Kroft: Does doing something about energy . . . is it less important now than . . .

[Mr. Obama: No.]

Kroft: Why?

Mr. Obama: Well, because this has been our pattern. We go from shock to trance. You know, oil prices go up, gas prices at the pump go up, everybody goes into a flurry of activity. And then the prices go back down and suddenly we act like it’s not important, and we start, you know, filling up our SUVs again. And, as a consequence, we never make any progress. It’s part of the addiction, all right.

That has to be broken. Now is the time to break it."


17. See Winstead.


19. It should be noted that in May 2007, the Department of Energy (DOE) issued its “Draft Request for Proposals (DRFP) Number DE-ERP3-06GO96031.” The purpose of the DRFP was to give “interest-ed parties the opportunity to provide comments and recommendations for improvements regarding all aspects of the document,” since many of the prequalified ESPC contractors were coming to the end of the periods of their prequalifications and the DOE was intending to reprocure these services. This was followed by the DOE issuing actual RFPs for the various regions of the country in July of 2007, at http://www.eere.energy.gov/golden/ESPC.aspx. It is our understanding that DOE has not made its selections of the successful awardees under these RFPs.


22. Id.

23. DEPPM Memo at 3-5.

24. DOE SDO Guidelines at 32, § 3.3.

25. Id. at 19, § 1.3.1. (emphasis added).

26. Id. at 32, § 3.4

27. Id. at 32, § 3.3.

28. Id. at 32, § 3.5.2.


30. One exception to ESCO’s providing all of the funding is explained in the DOE guidelines as follows:

One-time savings that are the result of the ESPC project can be applied to the project, usually as a pre-performance-period payment. For example, the agency may have been planning to replace a chiller using O&M/R&R funds, and then decide to include the chiller replacement in the ESPC project. The money that would have been used to replace the chiller in the absence of the ESPC project can be used to help pay for the ESPC project.


32. Weber, supra n. b.


34. See generally M. Klinger et al., SURETY’S INDEMNITY AGREEMENT (ABA Fidelity and Surety Comm. of TIPS, 2002), pp.1-25.

35. See generally E. Gallagher, Chapter 23: The Surety’s Subrogation Rights, LAW OF SURETYSHIP (ABA Fidelity & Surety Committee of TIPS, 2nd ed. 2000).


38. Flynn at 1-3.

39. One of the reasons for this may be found in a statement found in CRS report for Congress: Anthony Andrews, Energy Savings Performance Contracts: Reauthorization Issues (Order Code RL32543, updated September 1, 2004): “To date more than 340 ESPCs have been awarded with a total value of approximately $1.6 billion in private sector investments. None have failed to produce energy and cost savings.”

When state and local governments are faced with a disaster, it is imperative that they, together with the federal government, have procurement tools in place to provide flexibility to facilitate and expedite the acquisition of necessary supplies and services, while safeguarding fundamental procurement principles, to the extent possible. While federal funding and support may provide a strong base line, the state and local melody must be well-orchestrated to ensure that necessary services and infrastructure are restored as quickly as possible. Disrupted oversight in the aftermath of a disaster can leave overworked public employees and contractors singing the blues, but preparedness will help bring them back to the “sunny side of the street.”

This program is designed to share the best practices and identify “jazzy” cutting edge solutions that are, and will be, instrumental to an expeditious and effective response in a disaster. The topic sessions have been composed to spotlight each panelist’s experience with, and input into, preparedness strategies, procurement and contract administration in crises, contract analysis and oversight, and current issues in regard to expedited procurement and joint governmental responses to emergencies and disasters.

What you need to know to maximize effective procurement “best practices” and address the need to ensure continuous movement of supplies and services throughout the process, will be covered in the program, including:

* The year in review
* Anticipating emergency response issues
* Collaborative solutions for reconstruction
* Challenges of oversight, including potential controversies and false claims

This will be an interactive program designed for those involved in the process—government executives, government contracts administrators, purchasing agents, attorneys, and contractor equivalents—where all will be encouraged to share their experiences and have their questions answered.

Join us on May 14 from 4 to 7 p.m. for an optional practicum and reception.

Complete program details will be available at: http://www.abanet.org/contract/admin/programs/2009spring.html
NEWS FROM THE CHAIR
(continued from page 2)

resulted. One such program was the C-5A; the contract was converted to a cost-plus-fixed-loss agreement. After a few years, the total package procurement concept ended, and guidance was issued requiring the use of cost-plus contracts for development work and prohibiting the use of fixed-price production contracts for the development of major systems.

Then, in the 1980s, there was another push for fixed-price contracting as a means to control costs on large development programs. The A-12 program remains the most significant reminder of that push. The termination of the A-12 program, and the litigation that followed, were factors that caused Congress to enact legislation to limit the use of fixed-price contracts for development efforts.

The Federal Acquisition Regulation addresses contract types. FAR Part 16 provides the types that are available and establishes criteria for selecting a particular contract type, including limitations on the use of cost-type contracts. These limitations reflect the belief that cost-type contracts “are suitable for use only when uncertainties in contract performance do not permit costs to be estimated with sufficient accuracy to use any type of fixed-price contract.”

In many situations, a fixed-price contract type will be preferred, but we should not ignore history. Fixed-price contracting in certain circumstances, especially where development uncertainties and risks are significant, is inappropriate. A legislated preference for fixed-price contracts regardless of the particular situation could lead to the same kinds of scenarios that we have seen before. The FY 2009 National Defense Authorization Act requires that by mid-July 2009 the FAR must provide guidance on the use of cost-type contracts. My hope is that the lessons of history will be considered, and past mistakes will not be repeated.

Fall Section Meeting in Napa
The title of the Section’s Fall Program in Napa, California, was “Uncorking the Tough Issues—How In-House and Government Attorneys Unravel Them.” We had a perfect combination of a great program, a great location, and great weather. The program focused on the toughest procurement law issues that we face today, and the timing was perfect as the long-awaited final rule imposing mandatory disclosure obligations on federal contractors and subcontractors was published the week of the program. Several panels, as well as a discussion during the Council meeting, addressed issues raised by the new rule. Among its provisions, this final rule, effective December 12, 2008, requires contractors to disclose violations of federal criminal law involving fraud, conflicts of interest, gratuities, bribery, or the civil False Claims Act when the contractor has “credible evidence” of a violation. Mentioned in Napa were the lack of a definition of “credible evidence,” questions that arise from the commentary accompanying the rule that discuss-
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