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January 1987

CONTRACT PRICING

Material Prices Overstated in Pershing II Contract



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**National Security and
International Affairs Division
B-219741**

January 30, 1987

The Honorable John O. Marsh, Jr.
The Secretary of the Army

Dear Mr. Secretary:

We have completed a review of the pricing of material under contract DAAHO1-85-C-A027 PZ0003 for Pershing II Missile System production by the Martin Marietta Corporation, Martin Marietta Orlando Aerospace, Orlando, Florida. This contract was selected as part of a nationwide review of the pricing of noncompetitive prime contracts awarded by the Department of Defense. Our objective was to determine whether Martin Marietta complied with the Truth in Negotiations Act (Public Law 87-653) in providing accurate, complete, and current cost or pricing data.

Martin Marietta did not disclose the most accurate, complete, and current cost or pricing data available, as required by the act. Price agreement was reached on April 24, 1985, and Martin Marietta should have updated its cost and pricing data as of that date. Because the data had not been updated since November 20, 1984, to reflect changes in material costs, Martin Marietta's prices for material were overstated by about \$1.2 million, including overhead and profit. Detailed information concerning the overpricing is included in appendixes I and II.

U.S. Army Missile Command and Martin Marietta officials stated that price agreement was reached on November 20, 1984, and that any overpricing should be measured as of that date. Both organizations submitted legal opinions, citing previous Comptroller General decisions to support their positions. We disagree with Martin Marietta and the Missile Command. As detailed in appendix III, actual price agreement was not reached until April 24, 1985, and Martin Marietta should have submitted and certified updated cost and pricing data as of that time.

We believe that the information in this report provides a basis for you to initiate action to recover the amount of the overpricing from Martin Marietta Orlando Aerospace, and we recommend that you direct the Commander, U.S. Army Missile Command, to take such action.

As you know, 31 U.S.C. 720 requires the head of a federal agency to submit a written statement on actions taken on our recommendations to

the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of this report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the President, Martin Marietta Orlando Aerospace Corporation; the Commander, Defense Contract Administrative Services Region, Atlanta, Georgia; the Atlanta Regional Director, Defense Contract Audit Agency; and the Department of Defense Office of Inspector General, Washington, D.C. Copies will also be made available to others upon request.

Sincerely yours,



Frank C. Conahan
Assistant Comptroller General

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Overpricing of Material Included in Martin Marietta's Pershing II Production Contract

Background

Public Law 87-653, as amended, requires that, with certain exceptions, contractors submit cost or pricing data in support of proposed prices for noncompetitive contracts. Contractors are also required to certify that the data submitted are accurate, complete, and current. In cases where Public Law 87-653 is applicable, a clause is included in the contract which gives the government a right to a price reduction if it is determined that the price was overstated because the data submitted were not in accordance with the statute.

On November 20, 1984, the U.S. Army Missile Command and Martin Marietta tentatively agreed to a contract price of \$257,552,000 for the fiscal year 1985 Pershing II Missile System production. Martin Marietta certified that the cost or pricing data furnished to the government were accurate, complete, and current as of that date. Missile Command, however, could not award a definitized contract at that time because the Army and Martin Marietta were negotiating various overhead rates, such as general and administrative, engineering, manufacturing, and material handling, for a forward pricing rate agreement applicable to the performance period of the planned contract.

Pending an agreement on the overhead rates, Missile Command awarded a letter contract (DAAHO1-85-C-A027) to Martin Marietta on December 7, 1984. The letter contract authorized Martin Marietta to start production, but limited its expenditure and obligation authority to \$100 million. The letter contract gave Missile Command an option to definitize the contract at the previously negotiated price within 60 days.

The overhead rates had not been settled when the options expired on February 4, 1985, and on February 5, Martin Marietta refused the government's request to extend the option to definitize the contract at the previously negotiated price. On April 2, 1985 (after the overhead rates were settled in March), Missile Command and Martin Marietta officials reopened price negotiations and, on April 24, 1985, agreed on a firm fixed price of \$257,052,000 (the November price less \$500,000 for deleted product warranties). The contract was signed on April 29, 1985. No cost or pricing data was submitted after November 20, 1984.

Martin Marietta and Missile Command officials contend that price agreement was reached on November 20, 1984, and that no cost or pricing data updates were required after that date. Although Martin Marietta, on February 5, 1985, refused to extend the 60-day option, it claims that its subsequent agreement on April 2, 1985, to definitize the contract at the previously agreed upon price effectively negated the February 4,

1985, expiration of its price offer. Missile Command's Chief Counsel generally agrees with Martin Marietta's position. We concluded that price agreement occurred on April 24, 1985, and Martin Marietta should have updated and certified its cost and pricing data as of that date. Our analysis of Martin Marietta's position is in appendix III.

Failure to Update Cost or Pricing Data Results in Overstated Material Prices

Martin Marietta's material prices were overstated by \$1,211,781, including overhead and profit. We reviewed a sample of 142 items of raw material and purchased parts and found that the prices for 77 items were not based on accurate, complete, and current cost or pricing data. The prices were overstated for 69 items and understated for 8 items. As shown in table I.1, the overstatements and understatements resulted primarily because Martin Marietta did not update previously submitted cost or pricing data showing actual purchase or recently negotiated prices for 74 items. In addition, the data were not updated for a change in requirements for two items, and included an unsupported price for one item. A complete listing of all the parts is in appendix II.

Table I.1: Reasons for Net Overstatements

Actual or negotiated prices not submitted	\$801,863
Changes in requirements not submitted	35,812
Unsupported price proposed	2,786
Total	840,461
Overhead and profit	388,083
Net overstatement	\$1,228,544

Examples of the errors and omissions in the data are summarized below.

Actual or Negotiated Prices

Before the April 24, 1985, agreement on the prime contract price, Martin Marietta had either negotiated prices or obtained updated quotes for 74 items which were proposed to the government on the basis of earlier vendor quotes and proposals. The newer prices were lower than Martin Marietta's proposed prices for 66 items and higher for 8 items.

For example, Martin Marietta proposed a total price of \$5,700,000 for six parts based on a proposal from a subcontractor. However, Martin Marietta had negotiated a price of \$5,335,000 with the subcontractor in January 1985 and did not disclose the lower prices to the government. As a result, prices were overstated by \$365,000.

Because they were not updated, some prices were also understated. For example, the company proposed a total price of \$141,960 for 280 guided missile fins (part number 11502394-1) based on a vendor quote of \$507 a unit. In February 1985, however, Martin Marietta purchased the parts for \$148,526, based on a unit price of \$530.45, without disclosing the higher price. In this case, prices were understated by \$6,566.

Changes in Requirements

Martin Marietta proposed a total price of \$24,768 for 144 ballasts (part number 60750948-7) based on a unit price of \$172. During an engineering design review on November 3, 1984, however, the requirement was changed to 48 units of a different ballast (part number 60750948-11) which were later purchased for \$5,484, based on a unit price of \$114.24. Martin Marietta's proposal was not updated to show the changed requirements. As a result, prices were overstated by \$19,284.

Martin Marietta also proposed a total price of \$39,576 for 311.28 gallons of liquid adhesive (part number M484B100) based on a unit price of \$127.14. Changes in manufacturing processes during October to December 1984 decreased the requirement by 130 gallons, but Martin Marietta did not inform the government of the changed requirements. As a result, prices were overstated by \$16,528.

Unsupported Prices

Martin Marietta proposed a total price of \$28,658 for 245 rubber sheets (part number C004A019) based on an estimated unit price of \$116.97. Martin Marietta could not, however, furnish any supporting data for the estimate nor did we find any in the contracting officer's files. The only cost or pricing data available was a procurement history which showed that, preceding and following the date of agreement on the prime contract price, Martin Marietta purchased the sheets for \$105.60 each. As a result, we believe that the prices were overstated by \$2,785.

Objective, Scope, and Methodology

Our objective was to determine whether Martin Marietta complied with Public Law 87-653 in providing accurate, complete, and current cost or pricing data for selected items of material. We conducted our review at Missile Command, Martin Marietta, and the Defense Contract Administration Services and Defense Contract Audit Agency resident offices at Martin Marietta.

**Appendix I
Overpricing of Material Included in Martin
Marietta's Pershing II Production Contract**

We reviewed prime contract file documentation, negotiation records, purchase order files, and related price proposals for contract DAAH01-85-C-A027 PZ0003. We also interviewed Martin Marietta representatives and government officials responsible for procurement and contract audit. We limited our review to a judgmentally selected sample of raw material and purchased parts which represented about \$22,997,365, or about 89 percent, of the \$25,905,523 proposed by Martin Marietta for factory material.

Our review was conducted between December 1985 and May 1986. Our review was performed in accordance with generally accepted government auditing standards.

Schedule of Overpriced Parts

Part number	Nomenclature	Proposed quantity	Proposed unit price	Most current unit price (as of 4/24/85)	Unit price difference	Overstated* (understated)
Actual or negotiated prices not submitted						
11502618-1	Rocker arm	140	\$222.00	\$164.00	\$58.00	\$8,120
11501030-1	Connector	70	481.32	461.90	19.42	1,359
11502622-1	Bushing lock	420	54.85	55.00	-0.15	(63)
13157785-009	Harness assy	70	1,599.31	1,305.24	294.07	20,585
11502441-029	Wiring harness	70	1,419.37	1,271.99	147.38	10,317
11502443-019	Wiring harness	70	1,389.75	1,180.60	209.15	14,641
13157783-009	Harness assy	70	1,278.96	1,043.40	235.56	16,489
11502442-019	Wiring harness	70	1,157.43	889.86	267.57	18,730
11502436-019	Wiring harness	70	1,053.00	821.11	231.89	16,232
11502434-019	Wiring harness	70	821.99	647.84	174.15	12,191
11502432-019	Wiring harness	70	819.98	647.20	172.78	12,095
11502438-019	Wiring harness	70	768.50	688.14	80.36	5,625
60751256-1	Separation adapter	24	1,319.60	1,026.84	292.76	7,026
11501231-1	Adapter	70	404.60	239.74	164.86	11,540
11501232-1	Adapter	70	404.60	253.25	151.35	10,595
11501230-1	Adapter	70	374.37	251.39	122.98	8,609
11502477-1	Support bracket	420	71.80	71.50	0.30	126
11503187-009	Support plate	280	73.75	74.75	-1.00	(280)
60750231-2	Accelerometer	48	1,206.50	1,200.00	6.50	312
60750231-1	Accelerometer	24	1,206.50	1,200.00	6.50	156
13086518-1	Pyrotechnic valve	70	1,312.28	1,257.78	54.50	3,815
11502004-1	Pyrotechnic valve	70	1,121.48	1,111.75	9.73	681
11501813-009-1	Pan assy	70	504.00	507.46	-3.46	(242)
H667B100	Hvy. wght. phenolic	3,876.25	17.52	13.94	3.58	13,877
H667E100	2-inch wide tape	1,400	19.95	17.07	2.88	4,032
NAS1474C3	Bolt	9,100	2.24	2.00	0.24	2,184
60750251-1	PCM multiplexer	24	17,764.79	17,054.20	710.59	17,054
60750247-3	Power supply	24	9,600.00	8,055.00	1,545.00	37,080
M38510/10104BGC	Amplifier	6,650	12.00	12.50	-0.50	(3,325)
11502352-3	Ring cont. casting	70	3,418.00	3,310.00	108.00	7,560
11501704-3	Pin-rivet collar	36,400	0.59	0.57	0.02	728
11502626-009	Hydraulic actuator	280	250.00	255.00	-5.00	(1,400)
11502615-009	Hydraulic actuator	140	255.00	250.00	5.00	700
11501454-1	Plate	210	120.00	147.50	-27.50	(5,775)
M6106/29-016	Relay	140	166.60	109.71	56.89	7,965
P19500-180-09	Transient suppressor	6,324	12.97	11.71	1.26	7,968

**Appendix II
Schedule of Overpriced Parts**

Part number	Nomenclature	Proposed quantity	Proposed unit price	Most current unit price (as of 4/24/85)	Unit price difference	Overstated* (understated)
P19500-180-03	Transient suppressor	7,294	\$11.24	\$10.79	\$0.45	\$3,282
11501720-019-13	Plate	70	585.75	574.04	11.71	820
11502394-1	Gui. missile fins	280	507.00	530.45	-23.45	(6,566)
60750842-1	Wind. ant. telemetry	96	1,316.21	1,366.23	-50.02	(4,802)
11502960-3	Regulator valve	70	1,027.00	593.00	434.00	30,380
11502644-009	Harness assy	70	1,510.08	1,341.33	168.75	11,813
11502653-009	Harness assy	70	1,323.20	1,168.16	155.04	10,853
11502697-009	Harness assy	70	967.84	891.52	76.32	5,342
11502663-009	Harness assy	70	960.73	885.97	74.76	5,233
11502637-009	Harness assy	70	947.67	875.39	72.28	5,060
11502630-009	Harness assy	70	752.86	694.16	58.70	4,109
11502677-009	Harness assy	70	728.16	669.55	58.61	4,103
11502684-009	Harness assy	70	696.77	640.90	55.87	3,911
11502670-009	Harness assy	70	675.39	620.74	54.65	3,826
11502691-009	Harness assy	70	604.14	555.56	48.58	3,401
11502879-009	Harness assy	70	466.80	441.07	25.73	1,801
11501663-009	Det. cartridges	660	515.89	515.81	0.08	53
13155187-1	Ballast	70	565.00	532.00	33.00	2,310
13155189-1	Ballast	70	510.00	481.00	29.00	2,030
13155186-1	Ballast	70	480.00	452.00	28.00	1,960
60750948-1	Ballast	192	161.00	114.62	46.38	8,905
13155188-1	Ballast	70	318.00	299.60	18.40	1,288
13157434-009	Backplane assy	70	1,687.87	1,552.87	135.00	9,450
10607654-5	Coupling half	280	166.42	155.50	10.92	3,058
11501270-1	Resistor	280	407.85	372.64	35.21	9,859
11501270-3	Resistor	280	407.85	372.64	35.21	9,859
11501667-009	Riveted ring	70	574.00	552.00	22.00	1,540
11501665-009	Riveted ring	70	556.00	539.00	17.00	1,190
11502926-7	Thruster assy	70	1,691.12	1,470.80	220.32	15,422
11502901-5	Thruster assy	140	732.91	715.90	17.01	2,381
60750245-3	Battery	24	3,885.00	3,715.00	170.00	4,080
JANTXV2N6764	Rectifier	840	61.95	45.75	16.20	13,608
Subcontract	(6 parts)	-	-	-(b)	-	365,000
Total		-	-	-	-	\$801,863

**Appendix II
Schedule of Overpriced Parts**

Part number	Nomenclature	Proposed quantity	Proposed unit price	Most current unit price (as of 4/24/85)	Unit price difference	Overstated* (understated)
Changes in requirements not submitted						
M484B100	Liquid adhesive	311.28	\$127.14	(c)	—	\$16,528
60750948-7	Ballast	144	172.00	—(d)	—	19,284
Total		—	—	—	—	\$35,812
Unsupported price proposed						
C004A019	Rubber sheets	245	116.97	105.60	11.37	2,786
Overpricing excluding overhead and profit		—	—	—	—	840,461
Overhead and profit		—	—	—	—	388,083
Total overpricing		—	—	—	—	\$1,228,544

^aTotals may not add due to rounding.

^bA subcontract with Airesearch included six parts which were proposed separately on the bill of materials. At negotiations, in November 1984, Martin Marietta proposed a bottom line price of \$5.7 million to the government for these items. However, before final agreement on price, Martin Marietta negotiated a bottom line price of \$5.335 million with Airesearch.

^cThe unit price did not change, but the required quantity was reduced by 130 gallons before final price agreement was reached.

^dA lower priced ballast, costing \$114,239 each, was substituted for this part, and the required quantity was reduced from 144 to 48 before final price agreement was reached.

Analysis of Martin Marietta's Position on Price Agreement Date

Martin Marietta provided their legal opinion, dated January 23, 1986, on the question of when price agreement occurred. The following chronology of events is adopted from Martin Marietta's legal memorandum. Our analysis follows the chronology.

(1) Martin Marietta and Missile Command reached price agreement on the fiscal year 1985 Pershing II missile production on November 20, 1984, at \$257,552,000.

(2) Martin Marietta submitted its Certificate of Current Cost or Pricing Data effective November 20, 1984, to Missile Command on December 5, 1984.

(3) A letter contract was awarded to Martin Marietta on December 7, 1984. This letter contract, rather than a fully definitized contract, was awarded because Missile Command could not obtain the requisite approvals from higher authority to definitize the contract as Martin Marietta was, at that time, negotiating new forward pricing rates. The letter contract contained a provision which allowed the government to either unilaterally definitize the contract at \$257,552,000 within 60 days of letter contract award (February 4, 1985) [or to unilaterally set the contract price after 60 days] or to reopen negotiations. The letter contract further provided that if the government elected to definitize within the 60-day period at \$257,552,000, no further cost and pricing data "should be" required.

(4) The option expired on February 4, 1985, as the government failed to definitize the contract before February 4, 1985, and Martin Marietta (on February 5) refused the government's request to extend the option to definitize at \$257,552,000.

(5) The forward pricing rate negotiations concluded in March 1985. The new negotiated rates were soon furnished to Missile Command. [Missile Command then decided that use of the rates were not advantageous to the government.]

(6) Missile Command requested Martin Marietta to renew its offer to definitize at \$257,552,000 in late March 1985.

(7) Martin Marietta, in an April 2, 1985, letter to Missile Command, agreed that the government could elect to definitize the letter contract at \$257,552,000 by April 27, 1985.

(8) In mid-April, Missile Command requested Martin Marietta to eliminate the rocket motors from the Contract Warranty Clause and reduce the negotiated price by \$499,998, the sum previously negotiated for the rocket motor warranty.

(9) Martin Marietta, in an April 24, 1985, letter to Missile Command, agreed that the government could elect to definitize the letter contract at \$257,552,000, less \$499,998 for deletion of the rocket motor warranty.

(10) Missile Command definitized the letter contract on April 29, 1985, at a total firm fixed price of \$257,052,002.

Martin Marietta asserts that the letter contract gave the government the option of definitizing the contract at anytime before February 4, 1985, at \$257,552,000. Martin Marietta also asserts, with respect to the post February 4, 1985, events, that the expiration of the option was waived by Martin Marietta in accordance with two Comptroller General decisions (United Electric Motor Company, Inc., B-191996, September 18, 1978, 78-2 CPD 206 and Radionic, Incorporated, B-185597, April 14, 1976, 76-1 CPD 252). Martin Marietta concludes that this waiver negates the February 4, 1985, expiration (and, presumably, its February 5, 1985, repudiation) of its price offer. Moreover, Martin Marietta, apparently premising its position on Federal Acquisition Regulation 15.804(f), claims that recertification of cost or pricing data is unnecessary since the revived option price is derived from the option price in the letter contract which was predicated on negotiations using certified cost or pricing data. Missile Command's General Counsel generally agrees with Martin Marietta's statement of facts and legal position.

The principle enunciated in United Electric and Radionic and relied on by Martin Marietta is that

"...a contracting officer may allow a bidder and offeror to waive the expiration of its bid and offer acceptance period so as to make an award on the basis of the bid and offer as submitted. The rationale therefore is that the only right conferred by expiration of the acceptance period is conferred upon the bidder and offeror, who may therefore waive such right and accept an award at its discretion. [Citations omitted.] Of course, waiver is not permitted if it would compromise the integrity of the competitive procurement system...."

The ultimate issue in both cases was whether the government could accept expired bids or offers, not, as here, whether cost or pricing data had to be submitted. Both cases also involved competitive procurements,

not a sole-source procurement as here. These cases are, therefore, not pertinent.

The purpose of the Truth in Negotiations Act is to provide the government with cost information on par with that possessed by the contractor. The act is aimed at cases where costs are known to the contractor, but such information is withheld from the government. (Grumman Aerospace Corporation, ASBCA No. 27476, slip op., May 29, 1986.) Consequently, contractors are required to submit cost or pricing data before contract award and to certify that data submitted, as of an agreed upon date, which shall be as close to the date of price agreement as is practicable, is accurate, complete, and current.

The expiration of a continuous offer, such as the option as in this case, brings the offer to an end and precludes acceptance by the offeree,¹ a fact recognized by the government's behavior here. Where an offer expires before acceptance, a request by the government to an offeror to extend or renew its offer is effectively, in the context of a negotiated procurement, a reopening of negotiations. The renewal of that offer and its acceptance by the government settles the contract price anew and creates anew the requirements for the submission of cost or pricing data and certification of data that is contemporaneous with the new price agreement.

By the terms of Martin Marietta's letter contract, upon the expiration of the government's option, the government could no longer exercise its option rights but could unilaterally definitize the contract price or reopen negotiations. The Missile Command requested Martin Marietta to renew its offer in late March. Although the Missile Command may have believed that the expired option price was advantageous to the government, at the time of Missile Command's request, no binding agreement on price existed between the parties.

Between the expiration of the option and the April agreement on price, over 2 months elapsed during which the government did not have current cost information on par with the contractor adequate to reach or evaluate contract price—the very situation the statute was designed to avoid. Martin Marietta, however, was in the position to agree to revive the offer based upon its own assessment of the benefits to be derived by contracting at the earlier price. And, unlike the equal sharing of risks

¹Waterman v. Banks, 144 U.S.C. 94 (1892); 35 Comp. Gen. 50 (1955); 16 id. 699 (1937); 14 id. 612.

for unfavorable changes in cost during the term of an option, after expiration of the option, the government, not Martin Marietta, was solely at risk for an unfavorable change in the anticipated contract's cost structure. Not to require Martin Marietta to submit accurate, current, and complete cost or pricing data under these circumstances defeats the statutory purpose of allowing the government to reach an informed agreement on contract price based on the disclosure of all accurate, complete, and most pertinent here, current data. Given the purpose of 10 U.S.C. section 2306(f), we do not believe, in the absence of a showing to the contrary, that data certified as accurate, complete, and current as of November 20, 1984, meets the requirements for accuracy, completeness, and currency with respect to the new price agreement reached on April 24, 1985.

Second, although we are advised that both the letter contract and the definitized contract incorporated by reference the clause authorizing a reduction in contract price for defective pricing, clearly there was no certificate beyond the one executed in December, and that certificate is not applicable to the negotiations in March and April. The existence of a certificate is not, however, a prerequisite to a recovery for defective pricing. Numax Electronics, Inc., 85-3 BCA 18,396 (ASBCA No. 29186, August 27, 1985). See also, M-R-S Manufacturing Co. v. United States, 492 F.2d 835 (Ct. Cl. 1974). Consequently, the lack of a current certificate should not bar recovery in this case.

As a final matter, to the extent that the Martin Marietta bases an argument on Federal Acquisition Regulation section 15.804.4(f),² it fails to recognize that after the option lapsed there was no option to "exercise" as contemplated by that section. Moreover, the argument that no cost or pricing data was required for the revived price because it was derived from the expired option price which was supported by data also fails. So long as the parties had not agreed to price, the act and its implementing regulations demand the submission of accurate, complete, and current data and the eventual certification of that data. That did not occur here, however. Thus, we conclude that the requirements placed upon the contractor by the act for the submission of accurate, complete, and current cost or pricing data required Martin Marietta to update and certify its data to support its April proposal.

²Federal Acquisition Regulation section 15.804.4(f) states: "The exercise of an option at a price established in the initial negotiation in which certified cost or pricing data was used does not require recertification."

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